Supreme Court, U.S.
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IN THE

Supreme Court of the United States

PETER SCHEIBER,

Petitioner,

v.

DOLBY LABORATORIES, INCORPORATED and
DOLBY LABORATORIES LICENSING CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

In a prior judicial era, various intellectual-property licensing practices were condemned *per se* without rule-of-reason testing for market power nor anticompetitive effect. During that era, United States world leadership in technical innovation declined concurrent with a decline in intellectual-property value and incentive to innovate under the patent laws. The *per se* rule of *Brulotte v. Thys Co.* has remained impervious to judicial and statutory reforms applying rule-of-reason testing to licensing practices. Judge Posner, while compelled to apply *Brulotte* in this case, characterized its nominal basis in patent extension as economically and legally erroneous. Here, it invalidated a royalty agreement made expressly to encourage market development.

1. Did the court below err in holding that royalties continuing until an agreed date after patent expiration in exchange for a lower rate, as proposed by the licensee to avoid inhibiting market development by raising its prices, are *per se* illegal patent extension?

2. Did the court below err in holding that "patent misuse —the doctrine applied in *Brulotte* and invoked here by Dolby—" applies to deny patentees relief in infringement actions and also in license enforcement actions (as here); but that reform to limit patent misuse by rule of reason applies in infringement actions, but not in license enforcement actions?

3. Did the court below err in holding that equitable relief is inapplicable here?

PARTIES TO THE PROCEEDING

Petitioner

Petitioner is Peter Scheiber, an individual citizen of the United States, residing in the Southern District of Indiana. Petitioner has no corporate affiliations. Petitioner ("Scheiber") was Plaintiff-Counterdefendant in the district court (No. 95 C 1531) and Appellant in the U.S. Court of Appeals for the Seventh Circuit (No. 01-2466).

Respondents

Respondents Dolby Laboratories, Inc. and Dolby Laboratories Licensing Corporation were identified in the district court as corporations of respective California and New York. Petitioner is unaware of any publicly held company owning ten per cent or more of either corporation's stock. Respondents ("Dolby") were Defendants-Counterclaimants in the district court and Appellees in the Seventh Circuit Court of Appeals.

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PETITION FOR WRIT OF CERTIORARI

Peter Scheiber respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered in this action on June 17, 2002.

ORDERS AND OPINION BELOW

In summary judgment (S.D.Ind. No. 95 C 1531, Docket No. ("Dkt.") 98), the Southern District of Indiana (per Godich, D.Mag.J.) denied Scheiber's motion for summary judgment on his claims for breach of contract, conversion, punitive damages and unjust enrichment; granted motion of respondents "Dolby" to deny Scheiber's motion; and denied Dolby's motion for restitution of "inadvertent" royalty payments. Final judgment was entered at Dkt. 161. The opinion of the court of appeals (7th Cir. No. 01-2466) (per Posner, J.) is published at 293 F.3d 1014. The order denying Scheiber's petition for rehearing with suggestion of rehearing en banc is not otherwise published.

JURISDICTIONAL STATEMENT

The Court of Appeals for the Seventh Circuit entered its opinion and order on June 17, 2002 and denied Scheiber's petition for rehearing with suggestion of rehearing en banc on August 1, 2002. Petitioner Peter Scheiber invokes this Court's jurisdiction under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The United States Constitution empowers Congress:

> To promote the Progress of Science and the Useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.

U.S. Const. art. I § 8, cl. 8.

The patent statute accordingly provides as follows:

> Every patent shall contain a short title of the invention

> and a grant to the patentee, his heirs or assigns, for the term of seventeen years, subject to the payment of fees as provided for in this title, of the right to exclude others from making, using, or selling the invention throughout the United States and, if the invention is a process, of the right to exclude others from using or selling throughout the United States, or importing into the United States, products made by that process, referring to the specification for the particulars thereof. A copy of the specification and drawings shall be annexed to the patent and be a part thereof.

35 U.S.C. § 154 (1988).

The Patent Misuse Reform Act provides as follows:

> No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following: . . . (4) refused to license or use any rights to the patent; or (5) conditioned the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product, unless, in view of the circumstances, the patent owner has market power in the relevant market for the patent or patented product on which the license or sale is conditioned.

35 U.S.C. § 271(d)(4),(5) = P.L. 100-703 Title II "Patent Misuse Reform" (1988)

STATEMENT OF THE CASE

In 1984, in settlement of a suit brought by Scheiber for infringement of his patents on the audio system known as "surround sound," Dolby's patent attorney and vice president

of licensing[1] proposed that, to avoid inhibiting market development by increasing its royalty rates to its surround-sound licensees, in exchange for a lower royalty rate, it would continue to pay royalties on U.S. sales beyond the expiration date of Scheiber's U.S. patents.[2] Scheiber acceded to the proposal, and the license agreement was so drafted. App. A at 1a-2a.

In 1994, after expiration of the U.S. patents, Dolby cut off all royalty payments. Scheiber sued, and Dolby defended by asserting unenforceability of the lower rate/longer period provision insofar as it required (in accordance with Dolby's proposal) payment on U.S. sales beyond the expiration of the U.S. patents. Its authority was *Brulotte v. Thys Co.*, 379 U.S. 29 (1964) ("*Brulotte*"), which held that a contract for payment of patent royalties beyond the expiration date of the patent is illegal and unenforceable *per se*.

Rather than returning to the sublicensees the proceeds of its illegal and unenforceable contractual promise to Scheiber, Dolby retained them. (Dkt. 82, Ex. N, No. 5; 7th Cir. no. 01-2466, Brief of Appellant ("Sch.App.Br."), p. 10.)

The Southern District of Indiana entered summary judgment holding Scheiber's claim for the "post-expiration royalties" to be unenforceable, also dismissing his claims of conversion, punitive damages and unjust enrichment as

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[1]Dkt. 29, Ex. 4; Dkt. 82, Ex. X; Sch.App.Br., pp. 9 ¶ 3 - 10 (citations to record).

[2]"Licensee has represented that market development will be inhibited if it increases its license rates . . . because of the addition of the Patent Rights. Accordingly, during the term of this License Agreement, Licensee shall pay . . ." (License agreement, Ex. A to Complaint, § 3.1 first sentence.) The license agreement being negotiated, and executed, was for a sublicensing right under five Scheiber patents, under which Dolby licensed essentially every important home audio/video manufacturer in the world.

automatic consequences of the holding of unenforceability. Summary judgment was ordered on June 1, 1999 (Dkt. 98); (amended) final judgment was entered on May 14, 2001 (Dkt. 161).

In his Notice of Appeal, filed June 8, 2001, Scheiber appealed "from a June 1, 1999 order (1) denying Scheiber's April 25, 1997 Motion for Partial Summary Judgment on the issue of breach of contract and (2) granting that part of Dolby's August 5, 1997 Motion for Summary Judgment which sought summary judgment against Scheiber's claims in this action," which claims included claims for breach of contract, conversion, unjust enrichment and punitive damages. (Dkt. 162). Dolby argued the merits of the conversion, unjust enrichment and punitive damages claims in its Brief of Appellees ("D.App.Br."), filed September 25, 2001 (at 40), and Scheiber responded in his reply brief ("Sch.Rep.Br.") filed October 25, 2001 (at 19).

Oral argument in the U.S. Court of Appeals for the Seventh Circuit took place on December 1, 2001, and the appeal was decided on June 17, 2002. The court held the contractual arrangement providing U.S. royalties after expiration of the U.S. patents to be unenforceable under *Brulotte*, further holding that Scheiber had waived his state-law and equitable claims. Scheiber's petition for rehearing was denied on August 1, 2002.

In applying the *Brulotte per se* rule to strike down the royalty provision, Judge Posner, writing for the panel, nonetheless "invited the Supreme Court to reconsider its rule in *Brulotte*."[3]

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[3]Henry C. Su, "From Hop-Picking Machines to Surround Sound: How Far Have We Come in the Economic Analysis of Post-Expiration Royalties," *AT-IP Report* - Electronic Newsletter of the Intellectual Property Committee of the American Bar Association Section of Antitrust Law, June 26, 2002.

REASONS FOR GRANTING CERTIORARI

This case presents important questions of federal law which have not been settled by this Court: Whether agreed continuation of royalty payments beyond the patent expiration date in exchange for a lower royalty rate, to reduce cost burden on a developing market, constitutes illegal extension of the legal patent monopoly; and whether the rule of reason applies to answering that question. At issue is the continued viability of *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), which decision the Seventh Circuit felt obligated to apply to invalidate procompetitive, voluntary license terms, even while characterizing it as the product of legal and economic error.[4]

Brulotte is the product of a bygone judicial era hostile to intellectual-property rights, when proliferation of *per se* rules invalidated pro-innovative and even procompetitive licensing practices.

In 1985, the President's Commission on Industrial Competitiveness, charged with the task of assessing the

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[4]Judge Posner states: "The Supreme Court's majority opinion reasoned that by extracting a promise to continue paying royalties after expiration of the patent, the patentee extends the patent beyond the term fixed in the patent statute and therefore in violation of the law. That is not true." Judge Posner observes that *Brulotte* is not "based on the interpretation of the patent clause of the Constitution, or of the patent statute or any other statute; but it seems rather to have been a free-floating product of a misplaced fear of monopoly" (App. A at 5a), that "royalty payments beyond the patent term" called for in a licensing agreement "do not represent an extension in time of the patent monopoly" (*Id.* at 4a); likewise "royalties [] calculated on post-patent term sales" (*Id.*).

The opinion notes, however, that "we have no authority to overrule a Supreme Court decision no matter how dubious its reasoning strikes us, or even how out of touch with the Supreme Court's current thinking the decision seems," further noting the necessity of "'leaving to [the Supreme] Court the prerogative of overruling its own decisions.'" *Id.* at 6a.

> United States' position in world markets, reported that this nation, which had long been a frontrunner in technological innovation, is now underinvested in research and development. One of the reasons for this phenomenon, the Commission suggested, is that rights to intellectual property have eroded to such a degree that investment in innovative activities is no longer profitable.

Rochelle Cooper Dreyfuss, "Dethroning *Lear*: Licensee Estoppel and the Incentive to Innovate," 72 *Va. L. Rev.* 677 (1986) A corrective trend based on legal and economic logic is, however, emerging:

> The trend of offering greater protection to patent owners is a reality. In fact, the trend mirrors the restrictions placed on antitrust enforcement against business, albeit "big business," by the current United States Supreme Court.

Richard Calkins, "Patent Law: The Impact of the 1988 Patent Misuse Reform Act and *Noerr-Pennington* Doctrine on Misuse Defenses and Antitrust Counterclaims," 38 *Drake L. Rev.* 175, 228 (1989) ("Calkins, "Patent Law"").

Brulotte v. Thys Co., 379 U.S. 29 (1964), a relic of a different judicial era, remains, a shipwreck rock in the tide of economic common sense. Judge Posner, writing for the Seventh Circuit panel in this case, citing prior analyses of *Brulotte* as the product of judicial error, observes that the decision has "been severely, and as it seems to us, with all due respect, justly criticized" (App. A at 3a), calling it "a free-floating product of a misplaced fear of monopoly" (*Id.* at 5a) and "out of touch with the Supreme Court's current thinking" (*Id.* at 6a).

I. Did the court below err in holding that royalties continuing until an agreed date after patent expiration in exchange for a lower rate, proposed by the licensee to avoid inhibiting market development by raising its prices, are *per se* illegal patent extension?

The United States Constitution encourages innovation to the benefit of the public by granting to inventors an exclusive right in their inventions. But this monopoly is circumscribed both in *time* and in *subject matter*:

> Congress shall have power . . . To promote the Progress of Science and useful Arts, by securing for limited Times to . . . Inventors the exclusive Right to their . . . Discoveries.

U.S. Const. art. I, § 8, cl. 8. The time of the exclusive right is limited, and the subject matter is limited to the inventors' discoveries. Congress, implementing the Constitutional purpose in statute, declared that

> every patent shall contain . . . a grant to the patentee . . for the term of seventeen years . . . of the right to exclude others from making, using or selling the invention.

35 U.S.C. § 154 (1988). The exclusive right is limited in time to seventeen years, and in subject matter, to the inventor's invention. It is apparent that the public-interest purpose requires both limitations. In 1942, this Court held:

> In construing and applying the patent law so as to give effect to the public policy which limits the granted monopoly strictly to the terms of the statutory grant . . the particular form or method by which the monopoly is sought to be extended is immaterial.

United States v. Univis Lens Co., Inc., 316 U.S. 241, 251 (1942). The *Brulotte* rule creates an island of *per se* unlawfulness in the temporal domain, with no counterpart in the subject-matter domain. On that island, holding of illegal extension of monopoly does not require factual testing for market power nor for anticompetitive effect. *Brulotte* prohibits

per se a licensing practice having advantages for licensees and for the market, devalues intellectual property and thereby discourages innovation.

Scheiber's creation of the technology on which was founded the worldwide paradigm shift from the stereo to the home theater (defined by surround sound) was a microcosm of typical corporate research and development. If the role that *Brulotte* would eventually play had been foreseen at the start of Scheiber's multi-year R&D effort, that effort (or at least the 1984 licensing of Dolby) would not have been economically justifiable.

A. *Brulotte* is the product of erroneous analysis of monopoly extension: contractual post-expiration royalties do not extend the patent monopoly and are consistent with the patent statute

Judge Posner devotes pages three through five of the opinion in this case to demonstrating the error of the 1964 *Brulotte* Court's holding that "royalties beyond the life of the patent" inherently extend the lawful, limited patent monopoly.[5] Judge Posner observes:

> The Supreme Court's majority opinion reasoned that by extracting a promise to continue paying royalties after expiration of the patent, the patentee extends the patent beyond the term fixed in the patent statute and therefore in violation of the law. That is not true. After

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[5]Judge Posner's prior opinion to similar effect in *USM Corp.*, 694 F.2d 505, 510-11 (1982), cert. denied, 462 U.S. 107 was cited in 10 Phillip E. Areeda *et al.*, *Antitrust Law* ("10 Areeda") at 489-90, in Calkins, "Patent Law," 38 *Drake L. Rev.* 175 at 188-192, and in Rochelle Cooper Dreyfuss, "Dethroning *Lear*: Licensee Estoppel and the Incentive to Innovate," 72 *Va. L. Rev.* 677 (1986) at 711 n.122, as well as in *Windsurfing*, 782 F.2d 995, 1001 n.9 (Fed.Cir. 1986), cert. denied, 477 U.S. 905, and in Senate Report 100-492 of the Judiciary Committee (1988).

> the patent expires, anyone can make the patented process or product without being guilty of patent infringement. The patent can no longer be used to exclude anybody from such production. . . . For a licensee in accordance with a provision in the license agreement to go on paying royalties after the patent expires does not extend the duration of the patent either technically or practically, because, as this case demonstrates, if the licensee agrees to continue paying royalties after the patent expires the royalty rate will be lower.

App. A at 3a-4a. Here, licensee Dolby proposed continuing the royalties past the expiration of the U.S. patents in exchange for a lower rate. (p. 3, n.2, *supra* = license agreement, § 3.1, opening.) "[R]oyalty payments beyond the patent term" called for in a license agreement "do not represent an extension in time of the patent monopoly." App. A at 4a, citing Harold See & Frank M. Caprio, "The Trouble with *Brulotte*: the Patent Royalty Term and Patent Monopoly Extension," 1990 *Utah L. Rev.* 813, 814, 851 ("Harold See"). "Royalties beyond the patent term are no different. If royalties are calculated on post-patent term sales, the calculation is simply a risk-shifting credit arrangement between patentee and licensee. The arrangement can be no more than that, because the patentee at that time has nothing else to sell." *Id.* Similarly, Areeda says:

> The *Brulotte* Court feared "the free market visualized for the post-expiration period would be subject to monopoly influences that have no proper place there." However, Justice Harlan correctly pointed out in dissent that the free post-expiration market in patented *ideas* would not be limited one iota by this license, for it did not prevent any manufacturer from incorporating the formerly patented technology into its own machine.

10 Areeda at 509. Harold See makes the same point:

> *Brulotte* is wrong in its assumption that a royalty that

> extends beyond the patent term is an extension of the patent monopoly. Post-patent term royalties serve useful economic functions, but only the patent itself, not the royalty paid, can bestow the monopoly power to exclude others from making, using and selling.

Harold See at 838.

> *Brulotte* is simply wrong in its conclusion that the receipt of patent royalties from licensees after the patent term expires somehow extends the patent monopoly. The legal monopoly no longer exists; therefore, no one can be excluded from making, using or selling the patented objects.

Id. at 851. Because agreed royalties beyond the patent term do not prolong the patentee's right to exclude,[6] they are **fully consistent with the patent statute**, which provides thus as to patent term:

> Every patent shall contain . . . a grant to the patentee for the term of seventeen years . . . of the right to exclude others from making, using, or selling the invention throughout the United States.

35 U.S.C. § 154 (1988). *The only monopoly right granted by the patent statute is the right to exclude* others from making, using or selling the invention for the life of the patent. Since contractual post-expiration royalties do not extend that right to exclude, they are consistent with the patent statute.

A recent analysis published in the electronic newsletter of the Intellectual Property Committee of the American Bar Association Section of Antitrust Law concludes:

> No improper extension or enlargement of the patent monopoly results from the payment arrangement bargained for in *Scheiber*. When a licensed patent has expired, the patentee no longer has any patent-related

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[6]nor, by implication, the ability to extract royalties for use of the invention,

> leverage or monopoly power to assert against anyone, including her licensee. What patent-related leverage she had she lawfully used in negotiating royalty terms with her licensee *ex ante*. Post-bargaining and post-expiration, the only leverage she retains lies in the contractual provisions that the parties have agreed upon. Surely the lawful exercise of contractual power cannot be an instance of patent misuse.

Henry C. Su, "From Hop Picking Machines to Surround Sound: How Far Have We Come in the Economic Analysis of Post-Expiration Royalties?," *AT-IP Report* - Electronic Newsletter of the Intellectual Property Committee, ABA Section of Antitrust Law, June 26, 2002, Conclusion.

B. *Brulotte*'s rejection of rule-of-reason testing is inconsistent with decisions of this Court and courts of appeal, Congressional intent and underlying policy

In 1964, the time of the *Brulotte* decision on which this case turns, the courts were vigorous in striking down practices feared to represent monopolistic expansion.

> The apex was reached in the 1960s when courts began awarding purported infringers treble damages for costs and attorney's fees incurred in successfully defending an infringement action. Richard Calkins, "Patent Law," 175, 177 (1989).

Tying arrangements, in both antitrust and patent contexts, were condemned without consideration of market power, pro- or anticompetitive effect or business justifications. That was the genesis of *Brulotte*: The Court made it clear that its *per se* holding of unenforceability of contractual post-expiration royalties was based on the premise that a patentee's using the "leverage" of the patent grant to obtain such royalties is "analogous to an effort to enlarge the monopoly of the patent by tieing [sic] the sale or use of the patented article to the

purchase or use of unpatented ones." 379 U.S. at 33.[7] Similarly, the Seventh Circuit, applying *Brulotte*, said that the Supreme Court had held post-expiration royalties to be *per se* illegal because they involved tying (*per se* misuse in 1964):

> Without evidence that the post-expiration royalties were not tied to the patent, the [Supreme] Court assumed that they were. "In light of those considerations, we conclude that a patentee's use of a royalty agreement that projects beyond the expiration date of the patent is unlawful *per se*."

Meehan v. PPG Industries, Inc., 802 F.2d 881, 883-884 (7th Cir. 1986). *Brulotte* was founded on the analogy of post-expiration royalties to tying the patent to unpatented products, which tying, in 1964, was condemned as misuse without regard to market power, anticompetitive effect and business justifications. In *Meehan*, as in this case, the Seventh Circuit felt bound to follow the superannuated *Brulotte per se* rule in dealing with post-expiration royalties, even though the courts were moving away from their earlier *per se* stance vis-à-vis tying itself, on which the *Brulotte* rule was based.

1. The courts apply the rule of reason

In one example of judicial application of the rule of reason to tying, in 1977 this Court reversed a decision of the Sixth Circuit that had found an illegal tying arrangement under the Sherman Act. The Court held that the facts did "not support the conclusion that petitioners had the kind of economic power

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[7]The Court said that the Brulotte contract's requirement for undiminished post-expiration royalties was "peculiarly significant in . . . view of" the contract's imposition of post-expiration restrictions on the use of the patented machines (379 U.S. at 31-32), which restrictions are absent in Dolby's license (Complaint, Ex. A (license agreement)). But the *per se* rule makes this distinction irrelevant to *Brulotte*'s application.

which Fortner had the burden of proving in order to prevail in this litigation." *U.S. Steel Corp. v. Fortner Enterprises*, 429 U.S. 610, 622 (1977).

Also in 1977, this Court overruled the prior *per se* prohibition of vertical restrictions, replacing it with a rule-of-reason approach: "But we do make clear that departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than—as in *Schwinn*—upon formalistic line drawing." *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 58-59 (1977).

In 1979, this Court overturned a Sixth Circuit decision that had invalidated a licensing agreement on grounds of conflict with the temporal restriction in federal patent law.

> [T]he Court observed that state law normally controls in the area of contract, and this remains true regarding intellectual property, unless state law conflicts with federal law. . . . The Court stated that federal patent law is designed "to foster and reward invention," to "promote[] disclosure of inventions" and "to assure that ideas in the public domain remain there." The Court held that in this case, state contract law was not inconsistent with federal purposes because enforcement of a contract provides "an additional incentive to invention" and "furthers the federal policy of disclosure."

Harold See at 831 (citing *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257, 262-263 (1979).[8]

In 1982, the Seventh Circuit denied that there could

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[8]"The Court emphasized that *Brulotte* had been based on the 'leverage' that the patent had granted the patentee to extract royalties beyond the date of expiration 440 U.S. at 265, and that leverage was of course missing in *Aronson*," where no patent was granted. App. A at 7a. But was not that patentee leverage also missing in *Scheiber*, where it was the licensee that proposed the post-expiration royalties in exchange for low royalty rate?

reasonably be misuse of a patent absent a showing of market power or anticompetitive effect. Chief Circuit Judge Posner explained:

> [If] misuse claims are not tested by conventional antitrust principles, by what principles shall they be tested? Our law is not rich in alternative concepts of monopolistic abuse; and it is rather late in the day to try to develop one without in the process subjecting the rights of patent holders to debilitating uncertainty.

USM Corp. v. SPS Technologies, 694 F.2nd 505, 512 (7th Cir. 1982), cert denied, 462 U.S. 107.

In 1986, this Court denied certiorari to a decision of the Federal Circuit, which stands in a unique statutory relationship to patent questions (28 U.S.C. § 1295). The Federal Circuit had required proof of effects similar to those caused by an antitrust violation in determining whether a license provision constitutes patent misuse:

> To sustain a misuse defense involving a licensing arrangement not held to have been per se anticompetitive by the Supreme Court, a factual determination must reveal that the overall effect of the license tends to restrain competition unlawfully in an appropriately defined relevant market.

Windsurfing Intl. v. AMF, 782 F.2d 995 1001-2 (Fed.Cir. 1986), cert. denied, 477 U.S. 905, (1986). The court noted that "Recent economic analysis questions the rationale behind holding any licensing practice per se anticompetitive" (*Id.* at 1001-2 n.9), citing Judge Posner in *USM Corp.* (*supra*) and "Competition Policy and the Patent Misuse Doctrine" by Roger B. Andewelt, Chief, Intellectual Property Section, Antitrust Division, U.S. Department of Justice (25 *Pat. Trademark & Copyright J.* (BNA) No. 604 at 41, 44-45 (Nov. 11, 1982)). *Id.*

In 1994, the First Circuit ruled that there could be no misuse of copyright unless the owner is shown to have market power and other elements of antitrust violation. *Data General*

Corp. v. Grumman Sys. Support Corp., 36 F.3d 1147, 1180-81 (1st Cir. 1994).

In 1997, in *Khan*, a case cited in the opinion in the instant case, this Court accepted the Seventh Circuit's "invitation" to overturn an existing *per se* rule against vertical price restraints which the Seventh Circuit had felt compelled to apply despite its analysis of the rule as unsound. *State Oil Co. v. Khan*, 522 U.S. 3 (1997), certiorari to the Seventh Circuit in *Khan v. State Oil Co.*, 93 F.3d 1358 (7th Cir. 1996, Posner, Chief J.) App. A at 6a-7a.

The above post-*Brulotte* examples of increasing application of rule-of-reason standards in formerly *per se* areas are taken from both patent and antitrust contexts in view of the courts' and "Congress' fundamental concern with the impact of an alleged misuse on *competition*, and the nature of 'competition' does not differ depending on whether a patent is involved." 10 Areeda at 491. Indeed, at this late date, *Brulotte* stands apart as a *sui generis* body of law impervious to the rule-of-reason approach being increasingly adopted by the courts to evaluate claims of monopoly abuse.[9]

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[9]In addition to the courts' move to testing for **market power** and **anticompetitive effect**, as illustrated above, **the Tenth Circuit has held licensor coercion to be a precondition of patent misuse**. The opinion in this case compares Dolby's license agreement with the one in *Brulotte*: "*Brulotte* involved an agreement licensing patents that expired at different dates, just like this case; the two cases are indistinguishable." App. A at 3a. What triggered the holding of *per se* illegality was the lack of decrease in royalty rate when the first patents expired. Another case exhibiting the same facts is the Tenth Circuit case *Well Surveys*, where

> there was no provision for change in royalty base or for diminution in royalty after the expiration of the Smith patent. On the basis of these findings the [district] court held that WSI had misused the Swift patent and granted the Perfo-Log motion for summary judgment.

2. Congress applies the rule of reason

As noted above, in 1985, the President's Commission on Industrial Competitiveness reported that the United States had fallen behind in world market leadership, owing in part to accumulated (judicial) erosion of intellectual-property rights. In 1988, the patent statute was amended by the enactment of the Patent Misuse Reform Act which provides, so far as bears on this case:

> No patent owner otherwise entitled to relief for infringement . . . of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having . . . conditioned the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product, unless, in view of the circumstances, the patent owner has market power in the relevant market for the patent or patented product on which the license or sale is conditioned.[10]

Well Surveys, Inc. v. Perfo-Log, Inc., 396 F.2d 15, 16 (10th Cir. 1968). The Tenth Circuit reversed, holding that

> "* * * in order to constitute a misuse, there must be an element of coercion, such as where there has been a request by a prospective licensee for a license under less than all of the patents and refusal by the licensor to grant such a license." . . . The question is whether the licensee was forced to enter into a package arrangement. . . . Freedom of choice is the controlling question.

Id. at 17-18. Here, Dolby requested the patent bundling with extended royalty obligation in exchange for a lower royalty rate.

[10]In this suit, Dolby pled, as an affirmative defense, that "Scheiber has misused, abused and/or illegally extended his rights." (Dkt. 58, p. 5). The end result was that Scheiber was "denied relief for infringement [and] deemed guilty of . . . illegal extension of the patent right": not in the infringement action (the normal field of

35 U.S.C. § 271(d)(5). The legislative history of 35 U.S.C. § 271(d)(4),(5) makes clear the concerns of parties such as the U.S. Department of Justice at the Act's inception in the Senate, as well as the intent of Congress when it approved the Act's final language.

> Some recent judicial decisions have created uncertainty in the high-technology community by invalidating licensing practices which do not have anticompetitive consequences * * *. The proposed legislation would send a reliable signal to the courts and the business community that would encourage, rather than discourage, technical innovation.

Senate Report 100-492 of the Judiciary Committee (1988) at 6 (Sen. Hatch) (asterisks in original).

> Both the presumption [of market power] and the misuse doctrine punish innovators engaged in procompetitive distribution and licensing practices.

Id. at 9.

> In order to reassure creators of new technology that the courts will not interfere with procompetitive patent licensing, **the misuse doctrine must not be applied in a manner that condemns competitively desirable licensing**.

Id. at 14 (Assistant Attorney General John R. Bolton on behalf of the U.S. Department of Justice: letter to the Senate Subcommittee on Patents, Copyrights and Trademarks) (emphasis added).

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application of the misuse doctrine) but later in the present contract action through application of *Brulotte* to void the contractual royalty provision that settled the infringement suit and was to provide the agreed relief for infringement. That provision bundled the U.S. and later-expiring Canadian patents for royalty purposes. "We may assume that the statute encompasses bundling." App. A at 9a. Dolby admitted that Scheiber does not have relevant market power. (Dkt. 82, Ex. N, No. 11.)

> The underlying complaint about current law with respect to patent misuse is that it was developed to address allegedly anticompetitive effects of patent licensing arrangements . . . the proposed modifications [to 35 U.S.C. § 271] should have a **pro-competitive effect**, insofar as they **require some linkage between the patent licensing practice and anticompetitive conduct**.

134 Cong. Rec. 32295 (Representative Kastenmeier, Chairman, House Subcommittee on Courts, Civil Liberties and the Administration of Justice) (emphasis added).

As cited above, the *Brulotte* Court was explicit that its *per se* condemnation of post-expiration royalties resulted from the extraction of such royalties being "analogous to . . . tieing [sic]." 379 U.S. 33. Senator Leahy addressed Congressional intent with respect to analogous practices in the Senate session that approved the final (House) language of the Reform Act:

> Courts have been inconsistent in their application of the misuse doctrine to analogous practices. Misuse has been found even where the conduct has no anticompetitive effect . . . **Reform of patent misuse will ensure that the harsh misuse sanction of unenforceability is imposed only against those engaging in truly anticompetitive conduct.**

134 Cong. Rec. 32471 (Sen. Leahy) (emphasis added). Areeda points out that

> the statute's "market power" requirement emphasizes Congress' fundamental concern with the impact of an alleged misuse on *competition*, and the nature of "competition" does not differ depending on whether a patent is involved. Thus the statute is fully consistent with, though it does not mandate, virtually complete convergence of antitrust and [patent] misuse standards.

10 Areeda at 491. In current antitrust law, the touchstone is

factual testing for market power[11] and anticompetitive effect.

C. *Brulotte*'s rejection of rule-of-reason testing inhibits procompetitive patent licensing, devaluing intellectual property and reducing incentive to innovate

Erosion of intellectual-property value has reduced incentive for technical innovation and weakened the United States' standing in the world market. Licensing is the vehicle through which intellectual-property value, and the incentive to innovate embodied in the patent laws, are actualized.

> Licensing, cross-licensing, or otherwise transferring intellectual property (hereinafter, "licensing") can facilitate integration of the licensed property with complementary factors of production, which include manufacturing and distribution facilities, workforces, and other items of intellectual property rights. This integration can lead to more efficient exploitation of the intellectual property, benefiting consumers through the reduction of costs and the introduction of new products. Such arrangements increase the value of intellectual property to consumers and to the developers of the technology. By potentially increasing the expected returns from intellectual property, licensing also can increase the incentive for its creation and thus promote greater investment in research and development.

USDOJ and FTC, *Antitrust Guidelines for the Licensing of Intellectual Property* § 2.3 (1995) In the *Guidelines*, the DOJ and FTC embrace a policy whereunder "[s]tandard antitrust analysis applies to intellectual property." *Id.* at 2.1. That is inconsistent with the *per se* condemnation in *Brulotte*.

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[11]Dolby admitted that Scheiber does not have relevant market power. (Dkt. 82, Ex. N, No. 11.)

The notion that licensing has a number of procompetitive benefits has now become well accepted by the courts. *See Windsurfing Int'l, Inc. v. AMF, Inc.*, 782 F.2d 995, 1001 n.9 (Fed. Cir. 1986) ("Recent economic analysis questions the rationale behind holding any licensing practice per se anticompetitive").

Among various licensing practices that have been challenged as patent misuse—tying arrangements (tie-ins), covenants not to compete (tie-outs), restrictions on use, total-sales royalties, post-expiration royalties, discriminatory royalties—post-expiration royalties is the one that remains impervious to the tide of current legal-economic thinking (due to the *Brulotte* rule), bypassing factual testing for anticompetitive effect. Ironically, it is the one most likely to have procompetitive effect.

> A common type of conduct that courts have sometimes held to be unenforceable is the effort by the patent owner to extract payment from the licensee after the patent has expired. Unfortunately, this conduct is **least harmful to society from an economic perspective.**.. Allowing the parties the flexibility to stretch out payment over a longer period simply gives them **another option, one that may be economically preferable to both parties.**

American Bar Assoc. Sec. of Antitrust Law, *Intellectual Property Misuse: Licensing and Litigation* (2000) at 137-138 (emphasis added). Here, at the licensee's request, this royalty arrangement was made expressly for its economically desirable effect of reducing cost burden on the market. (p. 3, n.2, *supra* = license agreement, royalty provision, opening.)

> From a purely economic perspective, the current misuse doctrine seems flawed. Certain classes of conduct typically analyzed under the misuse doctrine, such as collecting royalties after the expiration of a patent, are at worst likely to be economically neutral and at best may be economically desirable and

therefore should be permitted.

American Bar Assoc. Sec. of Antitrust Law, *Intellectual Property Misuse: Licensing and Litigation* (2000) at 147. Noting once again the foundation of *Brulotte* in the (now relaxing) *per se* rule for tying,[12] Justice O'Connor observed that application of the latter

> incurs the costs of a rule-of-reason approach without achieving its benefits: the doctrine calls for the extensive and time-consuming economic analysis characteristic of the rule of reason, but then may be interpreted to prohibit arrangements that economic analysis would show to be beneficial.

Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 34 (1984).

As previously noted, this Court in *U.S. v. Univis*, 316 U.S. 241 (1942) articulated the principle that the particular form or method by which the patent monopoly is sought to be extended is immaterial. *Brulotte* is an anomalous holdover from a judicial era hostile to licensing. It exempts temporally extended royalties (which do *not* extend the patent monopoly) from the tests for market power and anticompetitive effect that are now generally applied—both in patent law and in antitrust law—before misuse or illegal extension can be found. (§ I.B., *supra.*)

This case perfectly exemplifies *Brulotte*'s effect of devaluing intellectual property and reducing incentive to innovate. Petitioner Scheiber undertook years of research and

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[12]"Increasingly, however, courts find a tying-type misuse only when the challenged conduct appears anticompetitive by antitrust standards. Such convergence is highly recommended." 10 Areeda at 480, referencing ¶ d1-3 at 487 ("genuine proof of tying market power is now required, and justifications can save an otherwise illegal tie" (referencing *U.S. Steel Corp. v. Fortner Enters. (Fortner II)*, 429 U.S. 610 (1977))).

development[13] to provide a technology meeting the need for a mass-market surround-sound system in anticipation of obtaining a negotiated patent royalty return. As patent licensor, he acceded to royalty terms proposed by Dolby, which had undertaken development of the home-entertainment market for surround sound, whereunder Scheiber would receive a smaller share in royalties collected by Dolby for a longer period, so as to reduce cost burden on the newly developing market.

The subsequent application of *Brulotte* to void this arrangement retrospectively made Scheiber's R&D effort financially unjustified. Rather than acceding to Dolby's proposal to make the mutually beneficial lower-rate/longer-term arrangement in 1984, Scheiber would have been better advised, owing to *Brulotte*, to exercise his patents' exclusionary power and continue to assert infringement. If a settlement then could be reached, it would have to be one not employing the device that the parties here agreed on to encourage market development by reducing the cost burden of royalties. (p. 3, n.2, *supra.*)

II. Did the court below err in holding that "patent misuse—the doctrine applied in *Brulotte* and invoked here by Dolby—" applies to deny patentees relief in infringement actions and also in license enforcement actions (as here); but that reform to limit patent misuse by rule of reason applies in infringement actions, but not in license enforcement actions?

The patent misuse doctrine is described as a defense to a patent owner's claim of infringement. Nonetheless, "patent misuse—the doctrine applied in *Brulotte* and invoked here by Dolby" (App. A at 13a) was used in this *license enforcement suit* to void the contractual royalty provision as illegal extension. Simultaneously, the court held that the statutory

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[13]See dates of application of the five patents licensed to Dolby.

reform of the misuse doctrine, which requires factual testing before illegal extension can be found, does not apply because "Scheiber isn't suing for infringement; he's suing to enforce a license agreement." App. A at 8a. That inconsistency underscores the equivocal and insular position of *Brulotte* as a *sui generis* body of law.

While stopping short of making an issue of whether the 1988 Reform Act overrules *Brulotte*,[14] the Act's legislative history speaks of a broad intent to encourage technical innovation by validating procompetitive licensing practices. (*See* § I.B.2, *supra*.) The Seventh Circuit opinion states that "certainly the statute encompasses [bundling]." App. A at 9a. Dolby proposed its license's bundling of the U.S. and Canadian patents for royalty purposes expressly to provide post-expiration royalties in exchange for a lower rate so as to encourage market development. (p. 3, n.2, *supra*); App. A at 1a-2a. "When a licensee requests a package of patents, a licensing package can be neither a tie nor a misuse." 10 Areeda at 497, citing *Zenith Radio Corp. v. Hazeltine Research*, 395 U.S. 100, 133-134 (1969) and *Automatic Radio Mfg. Co. v. Hazeltine Research*, 339 U.S. 827, 831 (1950). Scheiber did not offer rights under the Canadian patents (which expired after the U.S. patents); rather Dolby requested them. (Dkt. 48, Ex. G, § 1.1; Ex. H, § 107(b).)

Only this Court can rectify the illogic whereby a rule nominally applying the misuse doctrine—a defense to claims of infringement—applies to deny patentees relief in both infringement actions and contract actions, while reform to the misuse doctrine to preserve intellectual-property rights fails to reach contract actions. The remedy is to make the practice

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[14]This Court does not need statutory authority to modify *Brulotte*, which was not "based on the interpretation of the patent clause of the Constitution or of the patent statute or any other statute." App. A at 5a.

proscribed in *Brulotte* subject to the same rule-of-reason testing as the analogous practices formerly condemned as *per se* misuse.

III. Did the court below err in holding that equitable relief is inapplicable here?

The court of appeals decision in this case sets a precedent permitting patent infringers to settle their infringements by undertaking unenforceable obligations in exchange for rights under the patent, relying on the courts to void the obligations while upholding the rights.

Scheiber's complaint in the district court asserted claims for compensatory and consequential damages and all other relief proper in the premises (Complaint, Dkt. 1, cts. I, II); treble damages, interest, costs, attorney fees caused by Defendants' exertion of unauthorized control over Scheiber's property (*Id.*, ct. II)[15]; recovery of "damages in an amount by which Defendants have been unjustly enriched" (*Id.*, ct. III); punitive damages and all other relief proper in the premises (*Id.*, ct. IV).

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[15]Dolby's district court and appellate briefing recognized that Indiana law governs Scheiber's state-law claims (cl. II, III, IV). (Dkt. 62 at 13-15; D.App.Br. at 41-42.) Under Indiana law, unauthorized control (I.C. 35-43-4-1) over the property of another person constitutes criminal conversion. I.C. 35-43-4-3. Unauthorized control with intent to deprive the other person of any part of the property's value or use is theft. I.C. 35-43-4-2. Where the value of the property exceeds $100,000, this is a Class C felony. *Id.* "Property" includes money and contract rights, and is "of another person" if the other person has an interest in it, even if an accused person also has an interest in it. I.C. 35-41-1-23. Treble damages apply under I.C. 34-4-30-2 (to 1998) and 34-24-3-1. At all times, Dolby separately accounted for the money due Scheiber under the license agreement. (Dkt. 82, Ex. P, Q (Sony and Kenwood royalty reports to Dolby); S (Dolby report to Scheiber); Dkt 96, Ex. A "Royalties on Surround Products.")

The district court's summary judgment addressed these claims. Page 22 carries the heading "Mr. Scheiber's Remaining State Law Claims," with the subheadings "1. Conversion and Punitive Damages" and "2. Unjust Enrichment." The court dismissed all these claims on the ground that they depended on the success of the breach-of-contract claim, which failed under *Brulotte*. (Dkt. 98 at 22.)

The Seventh Circuit Opinion recognizes that *quantum meruit* restitution applies in cases like this one:

> a contract that is voided on grounds of illegality—Dolby's defense to Scheiber's suit for the agreed-upon royalties—is ordinarily treated as rescinded . . . the performing party can still claim the value of his performance . . . on a theory of *quantum meruit*, a type of restitution.

App. A at 15a. However, the Opinion goes on to say this:

> But Scheiber is not arguing that . . . he is entitled to some form of restitution of the benefits received by Dolby under [the contract] as a result of Dolby's being allowed to use Scheiber's patents without paying the full price that they had agreed upon. . . . In any event he makes no claim of *quantum meruit.*

Id. In fact, Count III of the complaint was a claim for recovery of "damages in an amount by which Defendants have been unjustly enriched." *Black's Law Dictionary* defines *quantum meruit* as an equitable remedy to compensate for unjust enrichment in the event that a contract is voided. Thus, the complaint raised the issue of *quantum meruit*, i.e., compensation for unjust enrichment.

Dolby "move[d] the Court to grant Dolby summary judgment on **all claims** asserted in the complaint," (Dkt. 61,

emphasis added),[16] and the court did so. Scheiber appealed the district court's "granting that part of Dolby's August 5, 1997 Motion for Summary Judgment which sought summary judgment against Scheiber's claims in this action." (Notice of Appeal, emphasis added.) In appealing the grant of judgment against "Scheiber's claims," Scheiber inherently appealed the grant of judgment against the state-law and equitable claims. Dolby acknowledged that these claims were on the table in the court of appeals by arguing their merits in its main brief:

> The district court's grant of summary judgment with respect to Scheiber's breach of contract claim necessarily disposed of his claims for conversion, unjust enrichment and punitive damages, all of which derived from Dolby's refusal to pay post-expiration royalties.[17]

(D.App.Br., p. 40.) Answering Dolby's argument in the court of appeals, Scheiber's reply brief says:

> The district court never reached the issue of the merits of my claims for conversion, unjust enrichment and punitive damages, but merely held that denial of these claims was an automatic consequence of its denial of my breach of contract claim as *per se* illegal—the ruling here appealed. (Dkt. 98, p. 22.) Reversal as to my breach of contract claim would thus eradicate the

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[16] Dolby's brief in support of its summary judgment motion states, "Scheiber's complaint is in four counts. . . . Count III claims that Dolby has been unjustly enriched because it failed to pay royalties to Scheiber but still benefitted from the use of Scheiber's technology licensed under the Agreement." (Dkt. 62, § III.)

[17] Dolby's statement of law is incorrect. "[A] contract that is voided on grounds of illegality—Dolby's defense to Scheiber's suit for the agreed-upon royalties—is ordinarily treated as rescinded, . . . [and] the performing party can still claim the value of his performance . . . on a theory of *quantum meruit*, a type of restitution." App. A at 15a.

> district court's sole basis for denying the remaining state-law claims. It would be absurd to reverse the denial of my breach of contract claim, and still uphold the denial of my remaining state-law claims that automatically resulted.

(Sch.Rep.Br., p. 19.)

In sum, Scheiber made claims in the district court for compensatory and consequential damages, conversion, punitive damages, and "damages in an amount by which Defendants have been unjustly enriched"; and appealed *pro se* the grant of Dolby's motion for summary judgment against these claims. Dolby argued Scheiber's appeal of the claims in the court of appeals. Technicalities should not be allowed to bar equitable relief to which a party is entitled, nor to work injustice. The Fifth Circuit has this to say:

> [T]he Supreme Court reversed the dismissal of an appeal by the First Circuit Court of Appeals where appellant had not specified in his notice of appeal that the appeal was from a judgment dismissing the complaint as well as from the order denying certain motions. *Foman v. Davis*, 371 U.S. 178, 83 S.Ct. 227, 9 L.Ed.2d 222 (1962). The Court stated, "It is too late in the day and entirely contrary to the spirit of the Federal Rules of Civil Procedure for decisions on the merits to be avoided on the basis of such mere technicalities." *Id.* at 181, 83 S.Ct. at 230.
>
> Similarly, in this circuit, it is well settled that an appeal is not lost if a mistake is made in designating the judgment appealed from where it is clear that the "overriding intent was effectively to appeal."

Kicklighter v. Nails by Jannee, Inc., 616 F.2d 734, 739 n.1 (5th Cir. 1980.) On the same question, this Court says:

> Following the simple guide of Rule 8(f) that "all pleadings shall be so construed as to do substantial justice," we have no doubt that petitioners' complaint adequately set forth a claim and gave the respondents

> fair notice of its basis. The Federal Rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits.

Conley v. Gibson, 355 U.S. 41, 48 (1957).

As a legal layman, Scheiber has particular trouble with the unavailability of equitable relief here. App. A at 11a-15a. "[P]atent misuse—the doctrine applied in *Brulotte* and invoked here by Dolby—is an equitable defense, and unclean hands can be asserted in opposition to an equitable defense." *Id.* at 13a. Under Indiana law,[18] "'Unclean hands' is an equitable doctrine which means that one who seeks relief in a court of equity must be free of wrongdoing in the matter before the court." *Community Care Centers, Inc. v. Sullivan*, 701 N.E.2d 1234, 1242 (Ind.Ct.App. 1994). Twenty years after *Brulotte* made post-expiration royalties illegal (in a ruling apparently well known in patent law circles) Dolby settled its infringement of Scheiber's surround-sound patents by sending its patent attorney and vice president of licensing to an Indiana negotiation[19] the existence of which it later denied in a sworn affidavit.[20] There, it proposed and agreed that, in exchange for lower royalty payments, it would continue to pay on U.S. sales after all the U.S. patents expired, until the later-

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[18]Dolby recognized that Indiana law applies to Scheiber's claims II, III and IV. (Dkt. 62 at 13-15; D.App.Br. at 41-42.)

[19]Dkt. 29, Ex. 4; Dkt. 82, Ex. X; Sch.App.Br., pp. 9 ¶ 3 -10 (citations to record).

[20]"Negotiations which led to the execution of the License Agreement occurred in interstate communication which were [sic] conducted by Dolby from Dolby's place of business in California." (Dkt. 20, Aff. of Dolby's vice president of licensing.)

expiring Canadian patents expired. Scheiber delivered the patent rights that this was to pay for. After the U.S. patents expired, Dolby cut off all royalty payments (U.S. and Canadian), successfully invoking summary judgment against the post-expiration royalty provision that it had proposed. It simply diverted to its own account the portion of royalties, collected from its sublicensees, that was due Scheiber under the arrangement that it had proposed, agreed to, and then successfully moved to be held illegal. (Dkt. 82, Ex. N, No. 5.)

CONCLUSION

As made clear in the opinion of the Seventh Circuit (App. A at 3a-7a), that court employed a rigorous application of *stare decisis* and precedent, applying a *per se* rule that it and its cited authorities believe to be the product of economic and legal error, and "out of touch with the Supreme Court's current thinking."

BECAUSE *Brulotte*'s rejection of the rule of reason is inconsistent with the current policies of the courts, the intent of Congress in relation to analogous practices, and current antitrust law; BECAUSE *Brulotte* inhibits procompetitive licensing, devalues intellectual property and discourages the technical innovation on which the United States' long-time world market leadership was founded, *Brulotte* should be overruled, or its application subjected to rule-of-reason testing for market power, anticompetitive effect, and licensor leveraging/coercion vs. licensee business justifications.

For the reasons set forth above, Peter Scheiber prays that his petition for writ of certiorari be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION AND JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT DATED JUNE 17, 2002

In the
UNITED STATES COURT OF APPEALS
for the Seventh Circuit

No. 01-2466

PETER SCHEIBER,

Plaintiff-Appellant,

v.

DOLBY LABORATORIES, INC.,
and DOLBY LABORATORIES LICENSING CORP.,

Defendants-Appellees.

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.
No. 95 C 1531—**John P. Godich**, *Magistrate Judge*.

ARGUED DECEMBER 3, 2001—DECIDED JUNE 17, 2002.

Before POSNER, EVANS, and WILLIAMS, *Circuit Judges*.

POSNER, *Circuit Judge*. The plaintiff in a suit to enforce a patent licensing agreement appeals to us from the grant of summary judgment to the defendants, Dolby for short. Scheiber, the plaintiff, a musician turned inventor who held

Appendix A

U.S. and Canadian patents on the audio system known as "surround sound," sued Dolby in 1983 for infringement of his patents. The parties settled the suit by agreeing that Scheiber would license his patents to Dolby in exchange for royalties. The last U.S. patent covered by the agreement was scheduled to expire in May 1993, while the last Canadian patent was not scheduled to expire until September 1995. During the settlement negotiations Dolby suggested to Scheiber that in exchange for a lower royalty rate the license agreement provide that royalties on all the patents would continue until the Canadian patent expired, including, therefore, patents that had already expired. That way Dolby could, it hoped, pass on the entire royalty expense to its sublicensees without their balking at the rate. Scheiber acceded to the suggestion and the agreement was drafted accordingly, but Dolby later refused to pay royalties on any patent after it expired, precipitating this suit. Federal jurisdiction over the suit is based on diversity of citizenship, because a suit to enforce a patent licensing agreement does not arise under federal patent law. E.g., *Jim Arnold Corp. v. Hydrotech Systems, Inc.*, 109 F.3d 1567, 1575 (Fed. Cir. 1997). The presence of a federal defense (here, patent misuse) is irrelevant to jurisdiction. *Christianson v. Colt Industries Operating Corp.*, 486 U.S. 800 (1988).

Dolby argues that the duty to pay royalties on any patent covered by the agreement expired by the terms of the agreement itself as soon as the patent expired, because the royalties were to be based on Dolby's sales of equipment within the scope of the patents and once a patent expires, Dolby argues, there is no equipment within its scope. The argument would make meaningless the provision that

Dolby itself proposed for continuing the payment of royalties until the last patent expired. Anyway the reference to equipment within the scope of the patent was clearly meant to *identify* the equipment on which royalties would be based (Dolby makes equipment that does not utilize Scheiber's patents as well as equipment that does) rather than to limit the duration of the obligation to pay royalties.

Dolby's principal argument is that the Supreme Court held in a decision that has never been overruled that a patent owner may not enforce a contract for the payment of patent royalties beyond the expiration date of the patent. The decision was *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), dutifully followed by lower courts, including our own, in such cases as *Meehan v. PPG Industries, Inc.*, 802 F.2d 881, 883 (7th Cir. 1986); *Virginia Panel Corp. v. MAC Panel Co.*, 133 F.3d 860, 869 (Fed. Cir. 1997), and *Boggild v. Kenner Products*, 776 F.2d 1315, 1318-19 (6th Cir. 1985). *Brulotte* involved an agreement licensing patents that expired at different dates, just like this case; the two cases are indistinguishable. The decision has, it is true, been severely, and as it seems to us, with all due respect, justly, criticized, beginning with Justice Harlan's dissent, 379 U.S. at 34, and continuing with our opinion in *USM Corp. v. SPS Technologies, Inc.*, 694 F.2d 505, 510-11 (7th Cir. 1982). The Supreme Court's majority opinion reasoned that by extracting a promise to continue paying royalties after expiration of the patent, the patentee extends the patent beyond the term fixed in the patent statute and therefore in violation of the law. That is not true. After the patent expires, anyone can make the patented process or product without being guilty of patent infringement. The patent can no longer

be used to exclude anybody from such production. Expiration thus accomplishes what it is supposed to accomplish. For a licensee in accordance with a provision in the license agreement to go on paying royalties after the patent expires does not extend the duration of the patent either technically or practically, because, as this case demonstrates, if the licensee agrees to continue paying royalties after the patent expires the royalty rate will be lower. The duration of the patent fixes the limit of the patentee's power to extract royalties; it is a detail whether he extracts them at a higher rate over a shorter period of time or a lower rate over a longer period of time.

This insight is not original with us. "The Brulotte rule incorrectly assumes that a patent license has significance after the patent terminates. When the patent term ends, the exclusive right to make, use or sell the licensed invention also ends. Because the invention is available to the world, the license in fact ceases to have value. Presumably, licensees know this when they enter into a licensing agreement. If the licensing agreement calls for royalty payments beyond the patent term, the parties base those payments on the licensees' assessment of the value of the license during the patent period. These payments, therefore, do not represent an extension in time of the patent monopoly . . . . Courts do not remove the obligation of the consignee to pay because payment after receipt is an extension of market power—it is simply a division of the payment-for-delivery transaction. Royalties beyond the patent term are no different. If royalties are calculated on post-patent term sales, the calculation is simply a risk-shifting credit arrangement between patentee and licensee. The arrangement can be no more than that,

because the patentee at that time has nothing else to sell." Harold See & Frank M. Caprio, "The Trouble with *Brulotte:* the Patent Royalty Term and Patent Monopoly Extension," 1990 *Utah L.Rev.* 813, 814, 851; to similar effect see Rochelle Cooper Dreyfuss, "Dethroning *Lear:* Licensee Estoppel and the Incentive to Innovate," 72 *Va. L. Rev.* 677, 709-12 (1986). "[T]he Supreme Court refused to see that typically such post-expiration royalties merely amortize the price of using patented technology." 10 Phillip E. Areeda *et al., Antitrust Law* §§ 1782c2-c3, pp. 505-11 (1996); cf. *Jahn v. 1-800-FLOWERS.com, Inc.*, 284 F.3d 807, 811-12 (7th Cir. 2002).

These criticisms might be wide of the mark if *Brulotte* had been based on the interpretation of the patent clause of the Constitution, or of the patent statute or any other statute; but it seems rather to have been a free-floating product of a misplaced fear of monopoly ("a patentee's use of a royalty agreement that projects beyond the expiration date of the patent is unlawful *per se.* If that device were available to patentees, the free market visualized for the post-expiration period would be subject to monopoly influences that have no proper place there," 379 U.S. at 32-33) that was not even tied to one of the antitrust statutes. 10 Areeda *et al., supra,* at §§ 1782c2, 1782c3, pp. 505, 511. The doctrinal basis of the decision was the doctrine of patent misuse, of which more later.

A patent confers a monopoly, and the longer the term of the patent the greater the monopoly. The limitation of the term of a patent, besides being commanded by the Constitution, see U.S. Const. art. I, § 8, cl. 8; *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 146 (1989),

and necessary to avoid impossible tracing problems (imagine if some caveman had gotten a perpetual patent on the wheel), serves to limit the monopoly power conferred on the patentee. But as we have pointed out, charging royalties beyond the term of the patent does not lengthen the patentee's monopoly; it merely alters the timing of royalty payments. This would be obvious if the license agreement between Scheiber and Dolby had become effective a month before the last patent expired. The parties could have agreed that Dolby would pay royalties for the next 100 years, but obviously the royalty rate would be minuscule because of the imminence of the patent's expiration.

However, we have no authority to overrule a Supreme Court decision no matter how dubious its reasoning strikes us, or even how out of touch with the Supreme Court's current thinking the decision seems. In *Agostini v. Felton,* 521 U.S. 203, 237 (1997), the Supreme Court "reaffirm[ed] that '[i]f a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the Court of Appeals should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions,'" quoting *Rodriguez de Quijas v. Shearson/American Express, Inc.,* 490 U.S. 477, 484 (1989); see also *State Oil Co. v. Khan,* 522 U.S. 3, 20 (1997); *Sasnett v. Litscher,* 197 F.3d 290, 292 (7th Cir. 1999); *National Foreign Trade Council v. Natsios,* 181 F.3d 38, 58 (1st Cir. 1999), aff'd. under the name *Crosby v. National Foreign Trade Council,* 530 U.S. 363 (2000) ("scholarly debate about the continuing viability of a Supreme Court opinion does not, of course, excuse the lower federal courts from applying that opinion"). In *Khan,* the lower court

(namely us), pointing out that the Supreme Court decision that we refused to declare defunct was clearly out of touch with the Court's current antitrust thinking, invited the Court to reverse, see *Khan v. State Oil Co.*, 93 F.3d 1358, 1363 (7th Cir. 1996), vacated and remanded, 522 U.S. 3 (1997), and it did, but pointedly noted that we had been right to leave the execution and interment of the Court's discredited precedent to the Court. *Id.* at 20.

In *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979), a case decided some years after *Brulotte,* the Supreme Court upheld a superficially similar arrangement: a patent applicant granted a license for the invention it hoped to patent to a firm that agreed, if a patent were not granted, to pay the inventor-applicant royalties for as long as the firm sold products embodying the invention. The Court was careful to distinguish *Brulotte,* and not a single Justice suggested that any cloud had been cast over the earlier decision. Since no patent was granted, the doctrine of patent misuse could not be brought into play, and there was no other federal ground for invalidating the license. The Court emphasized that *Brulotte* had been based on the "leverage" that the patent had granted the patentee to extract royalties beyond the date of expiration, 440 U.S. at 265, and that leverage was of course missing in *Aronson.*

If *Aronson* and *Brulotte* were inconsistent with each other and the Court had not reaffirmed *Brulotte* in *Aronson,* then we would have to follow *Aronson,* the later opinion, since to follow *Brulotte* in those circumstances would be to overrule *Aronson.* But the reaffirmation of *Brulotte* in *Aronson* tells

us that the Court did not deem the cases inconsistent, and so, whether we agree or not, we have no warrant for declaring *Brulotte* overruled.

Scheiber argues further, however, that *Brulotte* has been superseded by a 1988 amendment to the patent statute which provides, so far as bears on this case, that "no patent owner otherwise entitled to relief for infringement . . . shall be . . . deemed guilty of misuse or illegal extension of the patent right by reason of his having . . . conditioned the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product" unless the patentee has market power in the market for the conditioning product (which is not argued here). 35 U.S.C. § 271(d)(5). The statute is doubly inapplicable to this case. It merely limits defenses to infringement suits, and Scheiber isn't suing for infringement; he's suing to enforce a license agreement. He can't sue for infringement; his patents have expired. Scheiber argues that since the agreement was in settlement of his infringement suit, the only effect of limiting the statute to such suits would be to dissuade patentees from settling them. Not so. Had Scheiber pressed his 1983 infringement suit against Dolby to judgment, he would not have obtained royalties beyond the expiration date of his patents, because Dolby had not as yet agreed to pay any royalties; there was no license agreement before the case was settled. The significance of the statute is that if some subsequent infringer should point to the license agreement with Dolby as a misuse of Scheiber's patent by reason of the tying together of different patents, Scheiber could plead the statute as a bar to the infringer's defense of patent misuse.

In any event, the new statutory defense is explicitly limited to tying, *Lasercomb America, Inc. v. Reynolds*, 911 F.2d 970, 976 and n. 15 (4th Cir. 1990); *In re Recombinant DNA Technology Patent & Contract Litigation*, 850 F. Supp. 769, 775-77 (S.D. Ind. 1994), normally of a nonpatented product to a patented product, as in a number of famous patent misuse cases, such as *Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912), and antitrust tying cases, such as *International Business Machines Corp. v. United States*, 298 U.S. 131 (1936); *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942), and *International Salt Co. v. United States*, 332 U.S. 392 (1947). The 1988 amendment limited the tying doctrine, in cases in which the tying product is a patent, to situations in which the patentee has real market power, not merely the technical monopoly (right to exclude) that every patent confers. *Virginia Panel Corp. v. MAC Panel Co., supra*, 133 F.3d at 869. There are multiple products here, and they are tied together in the sense of having been licensed as a package. The more exact term is bundling, because a single price is charged for the tied goods, rather than separate prices as in the canonical tying cases. *United States v. Microsoft Corp.*, 253 F.3d 34, 87, 96 (D.C. Cir. 2001) (en banc) (per curiam); *Multistate Legal Studies, Inc. v. Harcourt Brace Jovanovich Legal & Professional Publications, Inc.*, 63 F.3d 1540, 1548 (10th Cir. 1985). We may assume that the statute encompasses bundling. We can't find a case on the point, but certainly the statutory language encompasses it and the objections to tying and bundling, such as they are, are the same. (The naive objection is that they extend monopoly; the sophisticated objection is that they facilitate price discrimination.) But it is not the bundling of the U.S. and Canadian patents on which Dolby pitches its refusal to pay

royalties; it is the duration of the royalty obligation. The objection would be the same if there were a single patent and the agreement required the licensee to continue paying royalties after the patent expired.

Brulotte called extending the royalty obligation beyond the term of the patent analogous to tying, 379 U.S. at 33, because the traditional objection to tying as we noted is that by telling the buyer that he can't buy the tying product unless he agrees to buy a separate product from the seller as well, the seller is trying to "lever" or "extend" his monopoly to the market for that separate product: only extending it in product space rather than in time. Yet if the seller tries to charge a monopoly price for that separate product, the buyer will not be willing to pay as much for the tying product as he would if the separate product, which he has to buy also, were priced at a lower rate. Acquiring monopoly power in the tied-product market comes at the expense of losing it in the tying-product market. *Advo, Inc. v. Philadelphia Newspapers, Inc.*, 51 F.3d 1191, 1202-03 (3d Cir. 1995); *Hirsh v. Martindale-Hubbell, Inc.*, 674 F.2d 1343, 1349 n. 19 (9th Cir. 1982). Thus, as these cases and a tidal wave of legal and economic scholarship point out, the idea that you can use tying to lever your way to a second (or, in the post-expiration patent royalty setting, a longer and therefore greater) monopoly is economic nonsense, imputing systematic irrationality to businessmen. Congress seems to have recognized this in the 1988 amendment. But even if the amendment should therefore be interpreted to reject the rationale of the tying cases, and even though the rationale of *Brulotte* is materially identical to that of the discredited tying cases—the Court even invoked "leverage" (as it emphasized

later in *Aronson*), saying that to "use that leverage [the power conferred by the monopoly] to project those royalty payments beyond the life of the patent is analogous to an effort to enlarge the monopoly of the patent," 379 U.S. at 33, and not a whit stronger (probably even weaker, since there is only one product), it would not follow that the statute had changed the rule of that case. Congress isn't constrained, as courts like to think *they* are, to rule logically. Most statutes are the product of compromise, and compromises need not cut at the logical joints of a controversy. There just is no evidence that Congress in the 1988 amendment wanted to go or did go beyond tying. Had it wanted to, it would have chosen different words. We are not literalists, but there must be *some* semantic handle on which to hang a proposed statutory interpretation, and there is none here, though we have found a district court case that did hold that the 1988 amendment had overruled *Brulotte*: *Sunrise Medical HHG, Inc. v. AirSep Corp.*, 95 F. Supp. 2d 348, 457-59 (W.D. Pa. 2000).

Scheiber has another ground for disregarding *Brulotte* that deserves consideration (again a ground supported by a lone district court decision, *A.C. Aukerman Co. v. R.L. Chaides Construction Co.*, No. CIV. 88-20704 SW, 1993 WL 379548, at *6 (N.D. Cal. Sept. 13, 1993), but one that misreads *Brulotte* as having been held in *Well Surveys, Inc. v. Perfo-Log, Inc.*, 396 F.2d 15, 17 (10th Cir. 1968), to be inapplicable to package-licensing agreements that contain expired patents unless the licensees were coerced into making the agreements). The ground is that Dolby comes into court with "unclean hands" that should not be allowed to touch and stain the Supreme Court's decision. Scheiber points out that it was Dolby that asked him to stretch out the royalties

until the last patent expired and that now seeks to get out of the obligation it not only accepted but volunteered to shoulder.

The doctrine of "unclean hands"—colorfully named, equitable in origin, and reflecting, in its name at least, the moralistic background of equity in the decrees of the clerics who filled the office of lord chancellor of England during the middle ages, *Shondel v. McDermott,* 775 F.2d 859, 867 (7th Cir. 1985); 1 Dan B. Dobbs, *Law of Remedies* § 2.4(2), pp. 92-93 (2d ed. 1993)—nowadays just means that equitable relief will be refused if it would give the plaintiff a wrongful gain. See, e.g., *Packers Trading Co. v. CFTC,* 972 F.2d 144, 148-49 (7th Cir. 1992); *United States v. Bob Stofer Oldsmobile-Cadillac, Inc.,* 853 F.2d 1392, 1398-99 (7th Cir. 1988); *Adler v. Federal Republic of Nigeria,* 219 F.3d 869, 871, 876-77 (9th Cir. 2000). "Today, 'unclean hands' really just means that in equity as in law the plaintiff's fault, like the defendant's, is relevant to the question of what if any remedy the plaintiff is entitled to. An obviously sensible application of this principle is to withhold an equitable remedy that would encourage or reward (and thereby encourage) illegal activity . . . . In what may have been the earliest application of the principle of unclean hands, a highwayman was refused an accounting against his partner in crime (and later hanged, to boot, along with the partner)." *Shondel v. McDermott, supra,* 775 F.2d at 868 (citations omitted). That is an apt description of the relief (in effect a partial rescission of the license agreement, and so equitable in character) sought by Dolby. But unfortunately for Scheiber it is an apt description of almost any case in which a party to a contract seeks relief on the basis that the contract is illegal.

Dolby is in effect a private attorney general, charged by *Brulotte* with preventing Scheiber from seeking to "extend" his patent and being rewarded for this service to the law by getting out of a freely negotiated royalty obligation.

The obvious problem is that Dolby is not seeking equitable relief; it just doesn't want to pay what it owes Scheiber under their licensing agreement on the ground that the agreement, or at least so much of it as creates the duty to pay that Dolby is flouting, is unlawful and therefore unenforceable. That is how the Court put it in *Brulotte v. Thys Co., supra,* 379 U.S. at 33-34. The effect is the same as rescission but that is true in any case where the payee in a contract is allowed to refuse payment because the contract is unenforceable. Scheiber is the plaintiff, seeking damages, and Dolby is pleading the defense of illegality to contract enforcement. See, e.g., *Kaiser Steel Corp. v. Mullins,* 455 U.S. 72, 77-83 (1982); *Northern Indiana Public Service Co. v. Carbon County Coal Co.,* 799 F.2d 265, 272 (7th Cir. 1986). In contrast, the remedy sought in the highwayman's case, an accounting, is an equitable remedy. But as if this weren't complicated enough, patent misuse—the doctrine applied in *Brulotte* and invoked here by Dolby—is an equitable defense, and unclean hands can be asserted in opposition to an equitable defense as well as being assertible as a defense to a claim for equitable relief. *Alcatel USA, Inc. v. DGI Technologies, Inc.,* 166 F.3d 772, 794 and n. 92 (5th Cir. 1999); *Conan Properties, Inc. v. Conans Pizza, Inc.,* 752 F.2d 145, 150 (5th Cir. 1985). The "theory" that makes this possible is that before the joinder of law and equity, an equitable defense to a legal claim had to be asserted in a separate proceeding in equity, in which the plaintiff in the

law case would be the defendant and so could plead the defense of unclean hands against the law defendant-equity plaintiff. *United Cities Gas Co. v. Brock Exploration Co.*, 995 F. Supp. 1284, 1296 n. 11 (D. Kan. 1998).

We needn't get deeper into this thicket of archaic distinctions, since it is apparent that to apply the doctrine of unclean hands in a case such as the present one would fatally undermine the policy of refusing enforcement to contracts for the payment of patent royalties after expiration of the patent. It would be (given the antimonopoly basis of *Brulotte*) inconsistent with the Supreme Court's rejection of the defense of *in pari delicto* ("equally at fault") in antitrust cases, *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134, 137-39 (1968), since the effect of that rejection is to give a party to a contract that violates the antitrust laws a defense to a suit to enforce the contract even if he entered into the contract with full knowledge. We even said in *General Leaseways, Inc. v. National Truck Leasing Ass'n*, 744 F.2d 588, 597 (7th Cir. 1984), in words that might have been uttered with the present case in mind, that "ever since the Supreme Court, in *Perma Life*, rejected the defense of *in pari delicto* in antitrust cases, it has been clear that whenever some maxim of equity (such as that to get equitable relief you must have 'clean hands') collides with the objectives of the antitrust laws, the equity maxim must give way." Later the Supreme Court equated "unclean hands" to *in pari delicto*. *McKennon v. Nashville Banner Publishing Co.*, 513 U.S. 352, 360 (1995); see also *Hartman Bros. Heating & Air Conditioning, Inc. v. NLRB*, 280 F.3d 1110, 1116 (7th Cir. 2002).

What is true is that a contract that is voided on grounds of illegality—Dolby's defense to Scheiber's suit for the agreed-upon royalties—is ordinarily treated as rescinded, meaning that the parties are to be put back, so far as possible, in the positions they would have occupied had the contract never been made in the first place. *Cox v. Zale Delaware, Inc.*, 239 F.3d 910, 914 (7th Cir. 2001); *United States v. Amdahl Corp.*, 786 F.2d 387, 392-93 (Fed. Cir. 1986). For example, even if a contract is unenforceable because it violates the statute of frauds, the performing party can still claim the value of his performance, net of any payment received before the contract was rescinded, on a theory of *quantum meruit*, a type of restitution. See, e.g., *Clark v. United States*, 95 U.S. 539, 541-42 (1877); *Beanstalk Group, Inc. v. AM General Corp.*, 283 F.3d 856, 863-64 (7th Cir. 2002). *Cox* and *Amdahl* involved contracts that were illegal, and not just unenforceable (there is nothing remotely "wrongful" about failing to memorialize in writing a contract that is enforceable only if so memorialized), yet *quantum meruit* would still have been available had the voiding party been unduly enriched by being able to walk away from the contract. But Scheiber is not arguing that if indeed the contract is unenforceable, as we believe it is, he is entitled to some form of restitution of the benefits received by Dolby under it as a result of Dolby's being allowed to use Scheiber's patents without paying the full price that they had agreed upon. Scheiber would be entitled to such relief only if the amount of royalties that Dolby did pay was less than the fair market value of Dolby's use of the patents, which of course it may not have been. In any event he makes no claim of *quantum meruit*.

Appendix A

Dolby was indeed entitled to summary judgment.

AFFIRMED.

A true Copy:

Teste:

_____

Clerk of the United States Court of Appeals for the Seventh Circuit

Appendix A

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

JUDGMENT – WITH ORAL ARGUMENT

Date: June 17, 2002

BEFORE: Honorable RICHARD A. POSNER,
Circuit Judge

Honorable TERENCE T. EVANS, Circuit Judge

Honorable ANN CLAIRE WILLIAMS,
Circuit Judge

No. 01-2466

PETER SCHEIBER,

Plaintiff - Appellant

v.

DOLBY LABORATORIES, INCORPORATED, and
DOLBY LABORATORIES LICENSING CORPORATION,

Defendants - Appellees

Appendix A

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division
No. 95 C 1531, John P. Godich, Magistrate Judge

The judgment of the District Court is AFFIRMED, with costs, in accordance with the decision of this court entered on this date.

APPENDIX B — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF INDIANA, INDIANAPOLIS DIVISION DATED JUNE 1, 1999

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

IP 95-1531-C-G

PETER SCHEIBER,

Plaintiff,

vs.

DOLBY LABORATORIES INC., and DOLBY LABORATORIES LICENSING CORPORATION,

Defendants.

ORDER

This cause comes before the Court on Plaintiff's Motion for Partial Summary Judgment, and on Defendants' Motion for Summary Judgment. Having considered the foregoing and being duly advised, the Court hereby DENIES Plaintiff's Motion for Partial Summary Judgment, and GRANTS-IN-PART and DENIES-IN-PART Defendants' Motion for Summary Judgment.

Appendix B

I. Background

A. Facts

In 1983, Plaintiff Peter Scheiber, and Audiodata, the company of which Mr. Scheiber was managing partner, sued Defendant Dolby Laboratories ("Dolby"[1]) for infringement of two United States patents. In November 1983, the suit was settled. The settlement agreement which was the product of that suit included a license agreement conveying to Dolby Laboratories the rights to make, use, lease and sell Professional Products.[2] In June of 1984, Dolby suggested entering into a new license agreement to extend Dolby's licensed rights to add the right to sublicense audio technology for use in consumer electronics equipment. An August 24, 1984 draft of the new license agreement, which added rights in two Canadian patents and two United States patents, included two separate royalty expiration dates, one for the United States patents, and the other for the Canadian patents.

Mr. Scheiber and Dolby finally entered into the second license agreement ("License Agreement") in November of

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1. Because the parties did not distinguish between Defendant Dolby Laboratories Inc., and Defendant Dolby Laboratories Licensing Corporation in their motions, the Court will likewise not distinguish the two for the purpose of ruling on the various motions, and will refer to both Defendants collectively as "Dolby."

2. All rights in the patents and licenses at issue in this case have subsequently been assigned to Mr. Scheiber. The Court therefore refers to Mr. Scheiber and/or Audiodata Company collectively as "Mr. Scheiber."

1984, which was retroactively effective as of March 1, 1984. Under the License Agreement, the parties agreed that "during the term of this License Agreement," Dolby would pay "a royalty of twenty per cent (20%) of a proportion of the license royalties received by [Dolby] from each sublicensee licensed under the Licensed Patents and reporting sales of Licensed Equipment. . . ." (Pl.'s Ex. A, ¶ 3.1.) The License Agreement defined "Licensed Equipment" as "systems . . . or . . . parts which function as sound decoder matrices . . . which sound decoder matrices fall within the scope of one or more claims of the Licensed Patents." (Pl.'s Ex. A, ¶ 1.2.) The License Agreement was amended in 1986 to provide additional rights and additional royalties. The 1986 amendment (the "Amendment") added that Dolby "shall in addition pay a royalty of 20 (twenty) cents per Licensed Equipment with Licensed Enhancement . . . for which [Dolby] receives license royalties based on sales under the Licensed Patents reported by sublicensees." (Pl.'s Ex. A, Amendment ¶ 3.11.) Licensed Equipment with Licensed Enhancement is defined in the Amendment as "multichannel sound systems or parts thereof . . . which function as sound decoder matrices with Licensed Audio Matrix Enhancement . . . [and] which fall within the scope of one or more claims of the licensed patents . . ." (Pl.'s Ex. A, Amendment ¶ 1.4.)

The License Agreement did not provide two separate royalty expiration dates for the United States and Canadian patents, as did the earlier draft of the agreement, but rather provided that "[t]he term of this Agreement shall be from the effective date hereof until the date of expiration of the last to expire patent in the Licensed Patents." (Pl.'s Ex. A, ¶ 5.1.) The term "Licensed Patents" is defined in the License

Agreement as "United States Patents 3,632,886; 3,746,792 and 3,959,590, and any reissued or reexamined patents based thereon and Canadian patents 1,004,603 and 1,037,877." (Pl.'s Ex. A, ¶ 1.l.) The last to expire United States patent included within the Licensed Patents was United States Patent 3,959,590, which expired on May 25, 1993. The last to expire of all the Licensed Patents was Canadian Patent 1,037,877, which expired on September 5, 1995. Dolby paid Mr. Scheiber royalties on sales of Licensed Equipment both in Canada and in the United States through the first quarter of 1994. Dolby paid $182,744.80 in royalties on Licensed Equipment sold in the United States between May 26, 1993, and March 31, 1994, after the United States patents had expired. Dolby did not pay Mr. Scheiber royalties on Licensed Equipment sold in either the United States or in Canada between April 1, 1994, and September 5, 1995. Unpaid royalties on Licensed Equipment sold in Canada between April 1, 1994, and September 5, 1995, when the last of the Canadian patents expired, totaled $67,686.59.

B. Procedural Background

Plaintiff Mr. Scheiber originally filed this action in the Circuit Court for Monroe County, Indiana. On November 17, 1995, Defendant Dolby removed the action to this United States District Court based on diversity of citizenship. On January 19, 1996, Dolby filed its Motion to Dismiss for Lack of Personal Jurisdiction or, Alternatively, to Transfer to a More Convenient Forum. On April 8, 1996, based on the consent of the parties, United States District Court Judge David F. Hamilton referred this case to the undersigned

Magistrate Judge for all subsequent proceedings. On April 21, 1997, this Court denied Dolby's Motion to Dismiss or to Transfer.

Plaintiff Mr. Scheiber filed his Motion for Partial Summary Judgment on April 25, 1997. Defendant Dolby filed its Answer and Counterclaim on July 14, 1997, to which Mr. Scheiber replied on August 4, 1997. On August 5, 1997, Dolby filed its Motion for Summary Judgment and a Brief in Opposition to Plaintiff's Motion for Summary Judgment, and in Support of Dolby's Motion for Summary Judgment. Upon leave of the Court, Dolby filed a Supplemental Brief in Support of Summary Judgment and Revised Defendants' Proposed Findings of Fact, Conclusions of Law and Judgment on December 1, 1997. Mr. Scheiber filed a Consolidated Brief in opposition to Defendants' Motion for Summary Judgment, and in Reply to Defendants' Brief in Opposition to Plaintiff's Motion for Partial Summary Judgment on April 1, 1998. On June 24, 1998, Dolby filed its Reply Brief in Support of Dolby's Motion for Summary Judgment. On October 2, 1998, Mr. Scheiber filed a Notice of Case Cite Correction, and on October 8, 1998, filed a Submission of New Evidence Supporting Criminal Conversion. Dolby filed a Response to Plaintiff's Submission of Evidence with Respect to his Conversion Claim on October 26, 1998.

II. Analysis

A. Summary Judgment Standard

Summary judgment is warranted only when there is no genuine issue as to any material fact and the moving party is

entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); *Vitug v. Multistate Tax Comm'n*, 88 F.3d 506, 511 (7th Cir. 1996). A Court deciding a motion for summary judgment must "consider all facts in the light most favorable to the non movant, resolving all inferences in his favor." *Vitug*, 88 F.3d at 511. The moving party bears the initial burden of production. *Id.* Once the moving party satisfies this burden, the non movant must put forth specific facts demonstrating a genuine issue for trial. *Id.*; *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1986). Summary judgment is not precluded by a factual dispute that does not affect the suit's outcome under governing substantive law. *Eckles v. Consolidated Rail Corp.*, 94 F.3d 1041 (7th Cir. 1996) (citing *Anderson*, 477 U.S. at 248; *Clifton v. Schafer*, 969 F.2d 278, 281 (7th Cir. 1992). The nonmoving party must do more than demonstrate "some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586, 106 S.Ct. 1348, 1356 (1986). "If the evidence is merely colorable, . . . or is not significantly probative, . . . summary judgment may be granted." *Whitaker v. T.J. Snow Co., Inc.*, 953 F.Supp. 1034, 1036 (N.D. Ind. 1997) (citing *Anderson*, 477 U.S. at 249-50, 106 S.Ct. at 2511 (citations omitted); *Griffin v. Air Line Pilots Ass'n., Int'l*, 32 F.3d 1079, 1084 (7th Cir. 1994); *Bostic v. City of Chicago*, 981 F.2d 965, 969 (7th Cir. 1992)). Furthermore, "[a] genuine issue for trial only exists where there is sufficient evidence favoring the non movant for a jury to return a verdict for that party." *Whitaker v. T.J. Snow Co., Inc.*, 953 F.Supp. at 1036 (quoting *Anderson*, 477 U.S. at 249, 106 S.Ct. at 2511; *Unterreiner v. Volkswagen of America*, 8 F.3d 1206, 1210 (7th Cir. 1993)).

Appendix B

B. Mr. Scheiber's Breach of Contract Claim

Each party argues that summary judgment in its favor is appropriate on Mr. Scheiber's breach of contract claim. The Court will consider each proposed basis for summary judgment in turn.

1. Whether the terms of the License Agreement and its Amendment Required Payment of Royalties on Products Sold in the United States Past the Expiration Date of the Last-to-Expire United States Patent

The License Agreement provided that it "shall be construed in accordance with the laws of the State of California." (Pl.'s Ex. A ¶ 6.14.) It also provided that "during the term of this License Agreement," Dolby would pay "a royalty of twenty per cent (20%) of a proportion of the license royalties received by [Dolby] from each sublicensee licensed under the Licensed Patents and reporting sales of Licensed Equipment . . ." (Pl.'s Ex. A, ¶ 3.1.) The License Agreement defined the term of the agreement as "from the effective date hereof until the date of expiration of the last to expire patent in the Licensed Patents." (Pl.'s Ex. A, ¶ 5.1.) Because the last to expire patent of the Licensed Patents is Canadian Patent 1,037,877, which expired on September 5, 1995, Mr. Scheiber argues that the above-quoted language unambiguously required Dolby to pay royalties on both United States and Canadian sales through September 5, 1995.

Dolby points out, however, that "Licensed Equipment" was defined in the License Agreement as "systems . . . or

. . . parts which function as sound decoder matrices . . . which . . . fall within the scope of one or more claims of the Licensed Patents." (Pl.'s Ex. A, ¶ 1.2.) Dolby argues that because the claims making up a patent expire when the patent expires, equipment sold in the United States as to which all United States patents had expired could no longer "fall within the scope of one or more claims of the Licensed Patents." (Dolby's Reply Br. at 3-4; Dolby's Suppl. Br. at 3.) Dolby argues it is therefore entitled to summary judgment on Mr. Scheiber's breach of contract claim, and additionally argues that for the same reason, it is "entitled as a matter of law to restitution for royalties mistakenly paid on equipment for which no valid and unexpired United States patent existed." (Dolby's Reply Br. at 4.)

Upon first reading, the Court is inclined to agree with Dolby that because the language of the contract defines "Licensed Equipment" as "systems . . . which . . . fall within the scope of one or more claims of the Licensed Patents," and equipment sold after a patent expires would no longer "fall within the scope" of a claim of a patent, the agreement does not provide for the payment of royalties on sales in the United States after the expiration of the United States patents. The Court does not reach the issue of whether the language of the agreement is so clear as to preclude contrary extrinsic evidence of the parties' intent, however, because as explained in the discussion below, federal patent law precludes the enforcement of any provision of a contract that would require the payment of post-expiration royalties.

Appendix B

2. Whether Federal Patent Law Forbids the Payment of Royalties on Expired Patents

Citing *Brulotte v. Thys Co.*, 379 U.S. 29, 85 S.Ct. 176 (1965) and *Meehan v. PPG Industries, Inc.*, 802 F.2d 881 (7th Cir. 1986) cert. denied, 479 U.S. 1091, 107 S.Ct. 1301 (1987), as authority, Dolby asserts that regardless of whether the language of the License Agreement required royalties on sales of equipment in the United States after all United States patents had expired, any such agreement would be void because it would violate established patent law forbidding payment of royalties on expired patents. (Dolby's Br. Opp. and Supp. Summ. J. at 5; Dolby Reply Br. at 5.) Although these two cases are on point and support the proposition for which Dolby cites them, Mr. Scheiber attempts several arguments opposing summary judgment in favor of Dolby on this basis. The Court will address each of these arguments.[3]

---

3. Although Mr. Scheiber first attempts an argument that the Court should not use the patent misuse doctrine to set aside a contract that is valid otherwise under state law, this Court rejects this argument for the simple reason that it goes against the Supremacy Clause of the United States Constitution. *See Goldstein v. California*, 412 U.S. 546, 569, 93 S.Ct. 2303, 2316, 37 L.Ed.2d 163 (1973) ("Obviously a State could not, consistently with the Supremacy Clause of the Constitution, extended the life of a patent beyond its expiration date. . . .").

Appendix B

a. Whether Brulotte and Meehan Can Be Distinguished

1. Brulotte

In *Brulotte*, a patent owner sold one patented hop-picking machine and a license for its use to each of several petitioners. *Brulotte v. Thys Co.*, 379 U.S. 29, 85 S.Ct. 176, 177 (1965). The license provided that each petitioner would pay a certain royalty amount each hop-picking season. *Id.* at 29, 85 S.Ct. at 177-178. The license listed twelve patents related to hop-picking machines, although the machines sold and licensed to the petitioners only incorporated seven of those patents. *Id.* at 30, 85 S.Ct. at 178. The seven patents incorporated into the machines expired on or before 1957, however, the licenses provided for the payment of royalties beyond that date. *Id.* Noting that "patents are in the federal domain," the United States Supreme Court followed an earlier holding that "'whatever the legal device employed' a projection of the patent monopoly after the patent expires is not enforceable." *Id.* at 32, 85 S.Ct. at 179. The Supreme Court then specifically held that "a patentee's use of a royalty agreement that projects beyond the expiration date of the patent is unlawful per se." *Id.* The Supreme Court went on to say:

> If that device were available to patentees, the free market visualized for the post-expiration period would be subject to monopoly influences that have no proper place there.

* * *

> A patent empowers the owner to exact royalties as high as he can negotiate with the leverage of that monopoly. But to use that leverage to project those royalty payments beyond the life of the patent is analogous to an effort to enlarge the monopoly of the patent by tieing the sale or use of the patented article to the purchase or use of unpatented ones. *See Ethyl Gasoline Corp. v. United States*, 309 U.S. 436, 60 S.Ct. 618; *Mercoid Corp. v. Mid-Continent Inv. Co.*, 320 U.S. 661, 664-665, 64 S.Ct. 268, 270-271, 88 L.Ed. 376, and cases cited. The exaction of royalties for use of a machine after the patent has expired is an assertion of monopoly power in the post-expiration period when, as we have seen, the patent has entered the public domain.

Id. at 32-33, 85 S. Ct. at 179-180.

This Court's research reveals that in the thirty-four years following the Supreme Court's issue of the *Brulotte* opinion holding an agreement to pay royalties after a patent's expiration unenforceable, the Supreme Court has not overruled that decision. The Supreme Court has distinguished *Brulotte* from a situation involving a contract under state law to pay royalties on the sale of a putative invention that was eventually determined by the Board of Patent Appeals to be unpatentable. *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257, 99 S.Ct. 1096, 59 L.Ed.2d 296 (1979). Noting that "[s]tate law is not displaced merely because the contract relates to intellectual property which may or may not be patentable; the states are free to regulate the use of such

intellectual property in any manner not inconsistent with federal law (citations omitted), the Supreme Court held that the contract in that case did not present "an obstacle to the accomplishment and execution of the full purposes and objectives" of the federal patent law system.[4] *Id.* at 262, 99 S.Ct. at 1099. Not only does the case before this Court clearly bear a closer resemblance to the situation in *Brulotte* than to the situation presented by *Aronson v. Quick Point Pencil Co.*, but the Seventh Circuit has explicitly interpreted *Aronson* as providing that had the patent in that case been issued, "enforcement of the royalty for exclusive rights beyond the life of the patent would have been precluded." *Meehan v. PPG Industries, Inc.*, 802 F.2d 881, 884 (7th Cir. 1986) (citing *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257, 263-264, 99 S.Ct. at 1099-1100.)

Mr. Scheiber attempts to distinguish the present case from *Brulotte* on several grounds. First, Mr. Scheiber points out that in *Brulotte*, each of the seven incorporated patents had expired, while in the present case and in *Automatic Radio Co. v. Hazeltine*, 339 U.S. 827, 70 S.Ct. 894, 94 L.Ed. 1312, which the *Brulotte* Court distinguished, at least one of the

4. The Court listed the purposes of federal patent law as follows:

> First, patent law seeks to foster and reward invention; second, it promotes disclosure of inventions, to stimulate further innovation and to permit the public to practice the invention once the patent expires; third, the stringent requirements for patent protection seek to assure that ideas in the public domain remain there for the free use of the public.

Id. at 262, 99 S.Ct. at 1099.

patents which were licensed as a group remained in force. This difference does not, however, negate the *Brulotte* holding's applicability to this case. First, the *Automatic Radio* Court did not tackle the issue of the effect of the expiration of any of the patents on the royalty agreement, *Brulotte v. Thys Co.*, 379 U.S. at 32 n.5, 85 S.Ct. at 179, and the *Brulotte* Court expressly "decline[d] the invitation to extend [its holding in *Automatic Radio*] so as to project the patent monopoly beyond the 17-year period." *Id.* at 32, 85 S.Ct. at 179. Secondly, there is no indication in *Automatic Radio* that the patent holder was attempting to exact royalties on domestic sales while the only remaining unexpired patents were foreign.

Finally, insofar as Mr. Scheiber attempts to distinguish *Brulotte* on the basis that other courts have held that it did not apply under circumstances similar to those in this case, the Court rejects Mr. Scheiber's argument in light of the Seventh Circuit's explicit reliance on *Brulotte* in its factually similar *Meehan* decision, as discussed in further detail below.

2. Meehan

Like Mr. Scheiber, the plaintiff in *Meehan v. PPG Industries, Inc.*, 802 F.2d 881 (7th Cir. 1986) brought a breach of contract action when the defendant stopped making royalty payments for the sales of his invention. *Id.* at 882. The invention at issue was patented in the United States, Canada, and the United Kingdom, and the contract required the defendant to make royalty payments to the plaintiff until the expiration of all patents. *Id.* at 883. As in this case, the defendant refused to pay royalties for sales in the United

States after the expiration of the United States patent. *Id.* Relying on the Supreme Court's reasoning in *Brulotte* and subsequent decisions from other circuits, the Seventh Circuit affirmed the district court's decision that the royalty provisions of the contract were unenforceable as a matter of federal patent law. *Id.* at 882. The Seventh Circuit stated:

> Under Brulotte when royalty payments extend unchanged beyond the life of a patent, patent leverage has been abused and the agreement is unlawful per se.
>
> Because the terms of the agreement demonstrate that the plaintiff used his right to obtain a patent to project his monopoly power beyond the patent period, the agreement is unlawful per se.

Id. at 886.

Mr. Scheiber first attempts to distinguish *Meehan* on the grounds that in *Meehan* "the royalty term was unclear", in that it "only set an outermost limit", whereas the present agreement "set a date certain for royalty obligations." (Pl.'s Consolidated Br. Opp. Def.'s Mot. Summ. J. and Reply Def.'s Br. Opp. ("Pl.'s Cons. Br.") at 12-13.) Mr. Scheiber points out that the contract in Meehan provided that the royalties "shall be payable . . . for a period of time *not to exceed* the life of any patent or patents granted . . . ," (Pl.'s Cons. Br. at 12-13 (quoting *Meehan v. PPG Industries, Inc.*, No. 84C 6967, 1985 WL 1999, *3 (N.D. Ill. 1985) (emphasis added)) whereas in the present case the License Agreement provided

that "during the term of this License Agreement, Licensee shall pay . . ." (Pl.'s Cons. Br. at 12-13 (quoting License Agreement, Pl.'s Ex. A, ¶ 3.1 (emphasis added)). Quite simply, this Court does not agree that this insignificant difference in the words the party chose could possibly render inapplicable the Seventh Circuit's clear holding in *Meehan* that where a contract requires a party to pay royalties on sales in the United States until the expiration of foreign patents, such a provision is unenforceable.

Similarly, this Court does not agree with Mr. Scheiber's argument that *Meehan* can be distinguished on the basis that the termination date of the royalty agreement was not specifically known, as it was in the present case. Nowhere in the *Meehan* decision does the Seventh Circuit state that this factor was a determinative consideration. In fact, the Seventh Circuit explicitly rejected that plaintiff's argument that because there was no patent (and thus no applicable termination date) at the time the agreement was made, the rule rendering unlawful any licensing agreement provisions that extend royalties beyond the life of an issued patent should not apply. *Meehan v. PPG Industries, Inc.*, 802 F.2d at 885. Furthermore, the Seventh Circuit expressly relied on *Brulotte*, in which the termination date of the royalty agreement was known. *See Brulotte v. Thys Co.*, 379 U.S. at 30 n.2, 85 S.Ct. at 178. Thus this difference does not render *Meehan* distinguishable for the purposes of our analysis.

Finally, this Court does not agree with Mr. Scheiber's attempt to distinguish *Meehan* on the grounds that that case involved an exclusive license to manufacture, whereas the present case involves a non-exclusive license to sublicense

to others. Again, there is no indication that the license's exclusivity was significant in the Seventh Circuit's analysis of *Meehan*, nor that the licensee in that case did not in fact have the right to sublicense to others and did not do so. This Court simply does not find this alleged difference, nor any others Mr. Scheiber puts forward, sufficient to render inapplicable the Seventh Circuit's *Meehan* decision applying the rule in *Brulotte* to a factual scenario so similar to the facts of this case.

b. Application of 35 U.S.C. § 271(d)

Mr. Scheiber argues that the 1988 Patent Misuse Reform Act ("Reform Act"), 35 U.S.C. § 271 (d)(5), eliminated the rule outlined in *Brulotte* and *Meehan* that post-expiration royalties are unlawful *per se*. Plaintiff cites the following portion of the statute in support of this argument:

> (d) No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following:
>
> * * *
>
> (5) conditioned the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product, unless, in view of the circumstances, the patent owner has market

> power in the relevant market for the patent or patented product on which the license or sale is conditioned.

35 U.S.C. § 271 (d)(5) (1988). Although Mr. Scheiber's argument regarding the applicability of this statute to this case is not entirely clear, he seems to be arguing that it completely eliminated *per se* findings of patent misuse, and Dolby therefore cannot avail itself of the type of patent misuse defense provided for in *Brulotte* and *Meehan*.

One of Dolby's several arguments in response is that the Reform Act only eliminated a patent misuse defense in certain situations involving "tying" arrangements, none of which are present in this case. This Court agrees. The language of the statute makes no mention of the lawfulness or unlawfulness of post-expiration royalties, which is the argument Dolby relies on under *Brulotte* and *Meehan* in this case. Dolby does not assert that the license agreements were unlawful because the patents were "tied" or licensed as a package, but gives a completely separate reason for the illegality of Plaintiff's interpretation of the contract: that the United States Supreme Court and the Seventh Circuit have explicitly held that licensing agreements providing for post-expiration royalties are unlawful *per se*. Furthermore, legislative history behind the Reform Act supports this Court's conclusion that only those patent misuse defenses involving tying arrangements were intended to be eliminated or narrowed by this legislation, rather than all patent misuse defenses: the Act deals only with ". . . a small piece of the patent misuse problem—tying arrangements—and leaves the rest for us to address in the future." *In re Recombinant DNA Technology*

Patent and Contract Litigation, 850 F.Supp. 769, 776-777 (S.D. Ind. 1994) (quoting 134 Cong. Rec. S17146-02 (daily ed. Oct. 21, 1988) (statement of Sen. Deconcini)). Additionally, in the time after the Patent Misuse Reform Act became effective, Courts have continued to refer to the rule in *Brulotte* as good law. *See, e.g., Virginia Panel Corp. v. Mac Panel Co.*, 133 F.3d 860, 869 (Fed. Cir. 1997); *Baladevon, Inc. v. Abbott Laboratories, Inc.*, 871 F.Supp. 89, 93 (D.Mass. 1994); *P.C. Films Corp. v. Turner Entertainment Co.*, 954 F.Supp. 711, 715 (S.D.N.Y. 1997). Furthermore, this Court's research reveals that and that no other court has interpreted the Patent Misuse Reform Act to eliminate the rule articulated in *Brulotte*, and more specifically in *Meehan*, that a provision in a license agreement providing for royalties on sales in the United States when all United States patents have expired is unlawful and unenforceable.

Insofar as Mr. Scheiber is arguing that the licensing of the United States and Canadian patents together was a "tying" arrangement which falls within the protection of the provision outlined above, the Court does not agree. The language of 35 U.S.C. § 271(d)(5) involves "those arrangements in which the patent license directly is tied to the purchase of a separate product," and also encompasses situations in which "the terms of the license prevents the licensee from purchasing or using a separate product." *In re Recombinant DNA Technology Patent and Contract Litigation*, 850 F.Supp. at 776-777. This Court's research reveals no cases in which licensing rights in United States and foreign patents together has been considered a "tying" arrangement invoking the application of either a "tying" type of patent misuse defense,

or this statute narrowing such a defense to cases in which the patent holder has market power. As noted by Dolby, the only cases Mr. Scheiber cites in support of his position involve the packaging or tying of United States patents, not United States patents with foreign patents. (See Def.'s Reply Br. at 13 n.10.)

Furthermore, whether the patents were in fact tied, or licensed together as a package, has no bearing on the enforceability of the License Agreement, because "tying" is not the grounds Dolby relies on for arguing that any agreement to pay royalties on United States sales past the expiration of all United States patents would be unenforceable. Dolby simply asserts that such agreements are unenforceable because the Supreme Court and the Seventh Circuit have clearly held that they are.

Thus the issues of whether the License Agreement also contained a "tying" arrangement, and whether such an arrangement would have been lawful in this case, are irrelevant due to the *per se* unlawfulness of any provision that may have required payment of royalties on United States sales after expiration of the United States patents. For this reason, Mr. Scheiber's other arguments relating to the inapplicability of a "tying" patent misuse defense are simply irrelevant. (*See* Pl.'s Cons. Br. at 15-19.)

c. Application of the "Clean Hands" Equitable Doctrine

Finally, Mr. Scheiber argues that "a party may not rely upon the equitable defense of patent misuse if that party has unclean hands." (Pl.'s Cons. Br. at 20 (citing *A.C. Aukerman Co. v. R.L. Chaides Construction Co.*, 1993 WL 379548, *6 (N.D.Cal. 1993)). "'Unclean hands' is an equitable doctrine which means that one who seeks relief in a court of equity must be free of wrongdoing in the matter before the court." *Community Care Centers, Inc. v. Sullivan*, 701 N.E.2d 1234, 1242 (Ind.Ct.App. 1994) (quoting *Foursquare Tabernacle v. Department of Metro. Dev.*, 630 N.E.2d 1381, 1385 (Ind.Ct.App. 1994)). However, "[t]he doctrine is not favored by the courts and is applied with reluctance and scrutiny." *Foursquare Tabernacle v. Department of Metro. Dev.*, 630 N.E.2d at 1385 (citing *Tomahawk Village Apartments v. Farren*, 571 N.E.2d 1286 (Ind.Ct.App. 1991)).

Although two other courts have applied the unclean hands doctrine to a patent misuse defense,[5] this Court declines Mr. Scheiber's invitation to apply the doctrine to enforce an agreement to pay royalties on sales based on expired patents. Such an agreement does not merely invoke a patent misuse defense, but the Seventh Circuit and the United States Supreme Court have explicitly held that such an agreement is unlawful *per se*. Equitable considerations do not force this

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5. *See A.C. Aukerman Company v. R.L. Chaides Construction Co.*, 1993 WL 379548, *6 (N.D.Cal.); *Touchett v. E Z Paintr Corp.*, 150 F.Supp. 384, 388 (E.D.Wis.1957).

Court to *order* that which the United States Supreme Court has declared unlawful.[6] Summary judgment in favor of Dolby is therefore appropriate on Mr. Scheiber's breach of contract claim.

C. Mr. Scheiber's Remaining State Law Claims

1. Conversion and Punitive Damages

Because Mr. Scheiber's conversion claim necessarily depended on the success of his breach of contract claim, and his claim for punitive damages in turn depended on the success of the conversion claim (see Pl.'s Cons. Br. at 33), the Court's grant of summary judgment in favor of Dolby on the breach of contract claim mandates the grant of summary judgment in Dolby's favor on the conversion and punitive damages claims as well.

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6. The Court will however, at an appropriate time, consider the possibility that Mr. Scheiber's "unclean hands" argument may be applicable to Dolby's counterclaim in equity for restitution of amounts that it paid on United States sales after expiration of the United States patents. *See St. Mary's Medical Center, Inc. v. United Farm Bureau Family Life Ins. Co.*, 624 N.E.2d 939, 941 (Ind. Ct. App. 1993) ("Restitution . . . is grounded in the equitable principle that one who has paid money to another who is not entitled to have it should not suffer unconscionable loss nor unjustly enrich the other."); *Briggs v. Clinton County Bank & Trust Co. of Frankfort, Ind.*, 452 N.E.2d 989, 1004 (Ind. Ct. App. 1983) ("the clean hands doctrine applies in restitution cases.").

2. Unjust Enrichment

For the same reasons that federal patent law precludes the enforcement under state law of a provision of a contract awarding royalties after the expiration of the patent upon which the royalties were based, this court will not use an equitable doctrine to *order* that which the United States Supreme Court has declared unlawful. *See Goldstein v. California*, 412 U.S. 546, 569, 93 S.Ct. 2303, 2316, 37 L.Ed.2d 163 (1973) ("Obviously a State could not, consistently with the Supremacy Clause of the Constitution, [have] extended the life of a patent beyond its expiration date. . . .").

D. Dolby's Restitution Counterclaim

Dolby cites *St. Mary's Medical Center, Inc. v. United Farm Bureau Family Life Ins. Co.*, 624 N.E.2d at 941, for the proposition that "if one party pays money to another party under a mistake of fact that a contract or other obligation required such payment, the payor is entitled to restitution." The Court concludes, however, that summary judgment is inappropriate on this claim.

Dolby asserts that Dolby's damages are ascertainable by simply offsetting the amount of royalties due through September 5, 1995, on Canadian sales, against Dolby's overpayments on United States sales. Dolby then contends that it mistakenly paid $182,744.80 in royalties on licensed equipment sold in the United States after the expiration of all United States patents on the equipment, and that it owed Mr. Scheiber $67,686.59 in royalties on licensed equipment

sold in Canada before the expiration of the Canadian patents, resulting in Dolby's net payment of excess royalties to Scheiber in the amount of $115,058.21. (Def.'s Rev. Proposed Findings of Fact ¶¶ 12-14.) Mr. Scheiber points out, however, that Dolby's sublicensees' royalty reports, upon which the computation of Dolby's royalty payments presumably depended, grouped together sales in Canada and the United States. (*See* Pl.'s Cons. Br. Ex. O, P, and Q.) In fact, Dolby admitted in a sworn interrogatory response that the royalty amount of $67,686.59 includes estimated Canadian sales/ royalty figures. (Pl.'s Cons. Br. Ex. N at 4, Interrog. No. 8.) The Court will not grant summary judgment and order payment of an amount in restitution where the amount suggested by the party seeking restitution offers "estimated" amounts. Fact issues therefore preclude summary judgment on Dolby's restitution claim. Furthermore, as mentioned above, although the Court will not order the parties to honor an unlawful contract provision, the Court may not be similarly obligated to order the "undoing" of what the parties have already done. In other words, should Dolby choose to bring its restitution counterclaim to trial, the Court will want to hear more from both parties regarding the cleanliness of Dolby's hands in these transactions.

Appendix B

III. Conclusion

IT IS THEREFORE ORDERED that Plaintiff's Motion for Partial Summary Judgment is DENIED, and Defendants' Motion for Summary Judgment is GRANTED-IN-PART and DENIED-IN-PART.

Dated this 1st day of June, 1999.

s/ John Paul Godich
JOHN PAUL GODICH, MAGISTRATE JUDGE
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA

APPENDIX C — AMENDED JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF INDIANA, INDIANAPOLIS DIVISION DATED MAY 14, 2001

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

CAUSE NO. IP95-1531-C-H/G

PETER SCHEIBER,

Plaintiff,

vs.

DOLBY LABORATORIES INC and DOLBY LABORATORIES LICENSING CORPORATION

Defendants.

AMENDED JUDGMENT

The Court amends its Judgment entered May 9, 2001 to read as follows:

The Court having heretofore entered its order on the parties' motion for summary judgment on June 1, 1999, granting defendants' motion for summary judgment on plaintiff's complaint and the parties having entered into a Stipulation of Dismissal Pursuant to Incorporated Agreement, and the Court having heretofore entered its Entry thereon, dismissing defendants' counterclaim,

Appendix C

H.I.

now, therefore,

IT IS HEREBY CONSIDERED AND ADJUDGED that plaintiff take nothing by its complaint and that plaintiff's claims in this action are hereby dismissed with prejudice. Defendants' counterclaim is dismissed without prejudice. Costs against plaintiff with respect to its claims, and the parties to bear their respective costs with respect to defendants' counterclaim.

IT IS SO ORDERED this 14th day of May, 2001.

By: JOHN PAUL GODICH
U.S. MAGISTRATE JUDGE

JOHN PAUL GODICH, MAGISTRATE JUDGE
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA

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APPENDIX D — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT DENYING PETITION FOR REHEARING AND PETITION FOR REHEARING EN BANC DATED AUGUST 1, 2002

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

August 1, 2002

Before

Hon. Richard A. Posner, *Circuit Judge*

Hon. Terence T. Evans, *Circuit Judge*

Hon. Ann Claire Williams, *Circuit Judge*

No. 01-2466

PETER SCHEIBER,

Plaintiff-Appellant,

v.

DOLBY LABORATORIES, INCORPORATED, and DOLBY LABORATORIES LICENSING CORPORATION,

Defendants-Appellees.

Appendix D

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.

No. 95 C 1531

John P. Godich,
Magistrate Judge.

ORDER

On July 15, 2002 plaintiff-appellant filed a petition for rehearing and petition for rehearing *en banc*. All the judges on the original panel have voted to deny the petition, and none of the active judges has requested a vote on the petition for rehearing *en banc*. The petition is therefore **DENIED**.